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Some Aspects of the Law of Reinsurance in Canada and Guatemala

by

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Abstract

Reinsurance is essential for the insurance industry. By reinsurance, the primary insurance companies cede the part of the accepted risks they cannot cover entirely because of their dimension, to bigger corporations called reinsurance companies. Despite its importance for the insurance industry, the concept of reinsurance is not well-known and the bibliography is limited. The number of cases in the area is small because the disputes that arise out of a reinsurance contract are usually settled by arbitration.

Unlike insurance, reinsurance has developed almost freely, without the close supervision governments exercise over primary insurance. The main reason for this situation is that the contract of reinsurance is usually an international contract and the reinsurers are foreign companies which cannot be supervised. Since the building of a reinsurance company requires much capital and expertise, few countries have been able to develop their own reinsurance industries. Therefore, the insurance companies of many countries must rely on foreign reinsurers to reinsure large portions of the risks accepted by domestic insurance companies.

This thesis has three purposes. First, it will present a comprehensive overview of the law of reinsurance. Second, it will compare some of the international aspects of reinsurance in Canada and Guatemala. These countries were selected because of their different legal systems (mostly Common Law in Canada and civil law in Guatemala) and because their economies are in different stages of development. Finally, this thesis will attempt to determine to what extent the reinsurance industry may continue to operate relatively free of governmental control.

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TABLE OF CONTENTS

PAGE

CHAPTER ONE

INTRODUCTION 1

CHAPTER TWO

GENERALITIES 4

(A) PRINCIPLES APPLICABLE TO REINSURANCE 5

1. Insurable interest 5
2. Utmost good faith 6
3. Indemnity 9

(B) ELEMENTS OF THE CONTRACT OF REINSURANCE 11

(C) PARTIES TO A REINSURANCE CONTRACT 12

(D) NATURE OF THE CONTRACT OF REINSURANCE 14

(E) THE SUBJECT MATTER OF REINSURANCE 15

(F) NECESSITY FOR REINSURANCE 16

CHAPTER THREE

METHODS FOR PLACING REINSURANCE 18

(A) FACULTATIVE METHOD 18

(B) TREATY 19

(C) OPEN COVER AND FACULTATIVE OBLIGATORY ARRANGEMENT 20

(D) REINSURANCE POOL 20

CHAPTER FOUR

TYPES OF REINSURANCE 21

(A) PRO-RATA OR PROPORTIONAL REINSURANCE 21

1. Quota-share treaty 21
2. Surplus treaty 23
3. Combined quota-share and surplus reinsurance 24
4. Main elements of reinsurance contracts 25
5. Rights and obligations of the parties under proportional reinsurance contracts 26

(B) NON-PROPORTIONAL OR EXCESS REINSURANCE 28

1. Excess of loss reinsurance 30
2. Stop loss and excess of loss ratio cover 31
3. Rights and obligations of the parties under non-proportional reinsurance contracts 32

CHAPTER FIVE
SPECIAL CLAUSES OF THE REINSURANCE CONTRACT 35
(A) THE INDEX OR STABILITY CLAUSE 35
(B) THE ERRORS AND OMISSIONS CLAUSE 36
(C) THE TERMINATION CLAUSE 37
(D) THE ARBITRATION CLAUSE 39
1. Reinsurance arbitration 41

CHAPTER SIX
REINSURANCE IN CANADA AND GUATEMALA 43
(A) REGULATION IN CANADA 43
1. The National Reinsurance Company of Canada 44
(B)REGULATION IN GUATEMALA 45
1. Registration of reinsurance contracts 46
2. Effects of the registration 46
(C) INTERNATIONAL PRACTICE OF REINSURANCE 47
1. Restrictions 48
(D) CONCLUSION 52

CHAPTER SEVEN
CONFLICTS OF LAWS IN REINSURANCE 54
(A) CANADA 54
1. The proper law of the contract 54
(B) GUATEMALA 60
1. The law of the contract 60
Conclusion 60
(C) ARBITRATION IN CANADA 61
(D) ARBITRATION IN GUATEMALA 67

Conclusion 69

(E) ENFORCEMENT OF FOREIGN AWARDS IN CANADA 70

(F) ENFORCEMENT OF FOREIGN AWARDS IN GUATEMALA 75

Conclusion 76

CHAPTER EIGHT

CONCLUSION 78

BIBLIOGRAPHY 82

APPENDICES 85

I. Introduction

Reinsurance is a concept unknown to many people. Very little literature of a comprehensive nature about reinsurance has been writtten.[1] Since the reinsurance contract is an insurance contract, a discussion of well-known principles of insurance will be made.

The importance of reinsurance has to be emphasized. Without reinsurance the insurance industry would not be able to survive by itself and to cope with the needs of the public. By means of reinsurance, insurers are able to increase their underwriting capacity, to have a better spread of the risks, to stabilize their losses, to reduce their reserves and to have expert advice.

The reinsurance industry has flourished in an environment almost free of governmental control in developing as well as in developed countries. For example, in both Guatemala and Canada, reinsurers are able to work freely without having assets in the country to respond for their obligations. However, the tendency of all governments is to attempt to control the activities of foreign reinsurers to provide protection for the public in case of insolvency. At the same time, all governments recognize the need to foster the type of business climate that will encourage reinsurers to work in their countries. Otherwise, if the access to foreign reinsurance is restricted or simply becomes unavailable, serious deficiencies in local insurance availability may arise and many risks will be left uncovered. Restrictions on international reinsurance are found not only in developing countries but also in countries with developed economies. Even in countries where the placing of reinsurance abroad is not prohibited, there are indirect restrictions in the form of discriminatory taxes, exchange controls affecting the investments of reserves and different rates of exchange for different transactions. To obtain a better risk distribution and higher growth rates, reinsurers attempt to operate in as many countries as possible. International expansion is a means not only of increasing the net volume of business of these corporations but also of achieving profit maximization through better risk distribution. Foreign reinsurance is especially important for developing countries, where premium income is relatively small and is not enough to cover large risks.

Once the international aspect of reinsurance is studied, it is easily understood why international private law plays such an important role in this industry, especially in regard to

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[1]R.L. Carter, Reinsurance; Golding, Law and Practice of Reinsurance, and Thompson, Reinsurance are among the most complete books on this topic.

arbitration.

The need for reinsurance has been growing throughout the world to such an extent that reinsurance premiums have increased faster than insurance premiums. While insurance premiums have almost quadrupled world-wide during the period 1965-1977, reinsurance premiums have increased almost six fold.[2]

Reinsurance plays its greatest role in Western Europe; second, in the United States and third, in Canada, Japan and Australia. Since the foundation of the first insurance company specializing in reinsurance, professional reinsurance companies have been established in most countries. In 1965 it was estimated that there were 200 companies operating throughout the world. Germany, the home of the first company, has four of the eleven leading reinsurance companies. Before the First World War, the continental companies dominated the international reinsurance markets. During the First and Second World Wars, the German companies lost business. However, they were able to recover and have kept the leading role. Munich Reinsurance Company is the largest reinsurer in the world, and Cologne Reinsurance Company, Gerling Global Reinsurance Company and Frankona Reinsurance Company are among the eleven largest reinsurers. The second main base of European reinsurance companies is Switzerland. The Swiss Reinsurance Company founded in 1863 is the second largest reinsurer in the world and is the largest international reinsurance company. Around three-quarters of the Swiss Reinsurance business is obtained from abroad. Four American reinsurance companies are among the world's top eleven reinsurers: the General Reinsurance Company, the American Reinsurance Company, INA Reinsurance Company and the Employers Reinsurance Company. The American insurance market is the largest in the world and this may explain why the business of the American reinsurers is mainly domestic. However, the major American reinsurance companies have entered the international market as sellers on a substantial scale in recent years. Great Britain has few reinsurance companies. The first company, the Reinsurance Company Limited, was established in 1867 but only survived for three years. Other companies were also founded but they did not last long. The Mercantile and General Reinsurance Company was established in 1907. It was a subsidiary of the Swiss Reinsurance Company but now it is owned by the Prudential Assurance Company. The

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[2]Financial Times, September 11 1979, p.1

Mercantile and General Reinsurance Company is the seventh largest reinsurer in the world. Many reinsurance companies have formal links with direct-writing insurance companies and some have been established by direct writers to handle their reinsurance accounts. Some big companies have shareholdings in direct-writing companies with whom they are closely associated. One of the newer market developments has been the formation of new reinsurance companies as an international venture by insurers of different countries. An example of an international venture is the formation in 1976 of the Norwich Winterthur Reinsurance Company by the Norwich Union Group of Britain, the Winterthur Insurance Company of Switzerland and the Chiyoda Insurance Company of Japan.

This thesis has three purposes. The first purpose is to present a comprehensive view of reinsurance in Canada and in Guatemala. Canada and Guatemala have been chosen, because these two countries have different legal systems -- mainly common law in the former and civil law in the latter. This presentation will point out that although civil and common law jurisdictions are different, the law of reinsurance is more or less the same because of its international character. The second purpose is to explain the importance of reinsurance for the insurance industry of the countries and to determine to what extent this industry can continue to operate as free from governmental control as it has done up to now. The third purpose is to explain some of the international elements involved in contractual relations between Canadian and Guatemalan parties.

II. Generalities

The contract of reinsurance is an insurance contract and is subject to the same general principles of insurance law. It has been defined as an undertaking whereby one insurer (reinsurer) agrees to protect another insurer (reinsured), wholly or partially, from a risk the latter has undertaken, both policies being in effect at the same time, and the original insured having no interest in the reinsurance.[3] Lord Mansfield, in the case of *Delver v. Barnes*,[4] defined reinsurance as "a new assurance, effected by a new policy, on the same risk which was before insured in order to indemnify the underwriter from their previous subscriptions; and both policies are in existence at the same time." In a contract of reinsurance, the reinsurer undertakes to pay or indemnify the reinsured if the latter suffers a loss as a consequence of the happening of an uncertain event. The uncertain event is the prospect that the insurance company, the reinsured, may become liable to make a payment or payments under a contract of insurance. To protect itself against the consequence of such liability, the insurance company enters into a contract of reinsurance.

The reinsurance contract may cover all the liabilities of the reinsured under the original insurance policy or only part of them. An American decision made this distinction:[5]

> While a contract of reinsurance implies the same subject matter of insurance as the original policy, and runs against perils of the same kind, it need not be for the identical hazard insured against in the first policy, but may be for a less, though not for a greater risk.

The contract of reinsurance is a different and separate contract from the insurance contract. The original insured is not a party to this contract. Therefore, there is no privity of contract between the original insured and the reinsurer. The case of *Kungl v. Cyr*[6] is the authority for the proposition that unless the contrary be stated therein, the reinsurance contract does not bind a third party and a stranger to the contract cannot base an action thereon. The same principle is applied in England and the United States.[7]

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[3] *National Ins. & Guarantee Corp. Limited v. Van der Veer* (1971), 322 N.Y.S.(2d), 293; 66 Misc.(2d), 862.
[4] (1807), 1 Taunt. 48, 51.
[5] *London Assurance Corporation v. Thompson*, 170 N.Y. 94.
[6] (1969), I.L.R. 1-242 (Que.C.A.).
[7] As Bingham J. said in *Western Assurance Company of Toronto v. Poole* (1903), K. 13, 376: There is no privity between the original assured and the reinsurer. The liability of the

However, the American legal system is different in that it accepts special provisions in the reinsurance contract giving the reinsured's policyholders an interest therein. American courts have held that a clause in a reinsurance contract giving an original insured the right to claim against the reinsurer is enforceable even though he is not a party to the contract. This clause is called a "cut-through" or "loss-assumption" clause. Its purpose is to permit an original insured who has been unable to obtain indemnity from his insolvent insurers to claim directly against the reinsurer for its share of the loss.

Reinsurance has to be distinguished from coinsurance. Coinsurance is useful in two situations. First, the insured may elect to carry a certain percentage of the risk himself. Second, an insurer may elect to distribute the risk among several companies and thereby reduce its liability. Each company bears a portion of the risk and obligates itself directly to the insured.

A. Principles Applicable to Reinsurance

Reinsurance is subject to the general principles of contract law and to the specific rules and principles applicable to insurance contracts. Therefore, the legal provisions relating to the intention to create a legal relation, offer and acceptance, consideration and capacity to enter into contracts apply to the formation, construction, performance and validity of reinsurance contracts. The most important of these principles concern insurable interest, utmost good faith and indemnity.

Insurable Interest

As with most contracts of indemnity insurance, in order to make a valid contract of reinsurance, the insurance company must have an insurable interest at the time the contract is made and at the time of loss. Generally, an insurance company will have an insurable interest if its insured has an insurable interest in the subject matter of the insurance contract, be it an interest in real or personal property, the success of a business venture or a desire to avoid the consequences of tortious liability. So long as an insured has an insurable interest, he can enter into a valid contract of insurance and his insurer, the

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[7](cont'd)latter is only to indemnify the insurer, the reassured, in respect of a loss for which he is liable to the assured by reason of his insurance policy.

reinsured, will have an insurable interest in the risk that it has undertaken.[8] Each of the insured and his insurer must have an insurable interest at the time of entering into the contract of insurance or reinsurance, as the case may be, and at the time of the loss.

A reinsurer is liable for the amount for which the insurer is legally liable,[9] or for the maximum amount the reinsurer has agreed to pay. The reinsurer's liability depends on the contract, which cannot be extended to cover items not included by its terms.[10]

Under reinsurance treaties (a treaty is an agreement whereby the insurer agrees to cede and the reinsurer binds itself to accept all risks ceded that belong to a certain category)[11] the reinsurance of any particular risk is in force from the moment the insurance company accepts the risk. In the case of facultative contracts (a facultative contract is an agreement whereby the insurer is free to cede or not the risks and to determine the proportion to be ceded and the reinsurer is free to accept or reject the risks offered)[12] the insurer negotiates the facultative contract before accepting the risk. So at the moment the insurer accepts the risk, the reinsurance contract will be in force. If the insurer accepts the risk without having reinsurance coverage, the reinsurer may backdate the coverage or grant coverage since the date of the reinsurance only. In the last two situations, the insurer has always an insurable interest when the reinsurance comes into force.

Utmost Good Faith

Since reinsurance is a contract of insurance, it is subject to the principle of *uberrimae fidei* or utmost good faith.[13] Both parties must exercise good faith and disclose all material facts.

> ...I think that on general principles of law relating to insurance contracts it is well settled by authority that failure to disclose a material fact invalidates the policy, not only in case of original insurance, but of reinsurance as well, in

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[8] *Colonial Ins. Co. of New Zealand v. Adelaide Marine Insurance Co.* (1886), 12 App. Cas. 128, 135; "...An insurance company carrying a risk has such an interest permitting it to reinsure."*Trotter and Douglas v. Calgary Fire Ins. Co.*(1910), W.L.R. 672; 3 Alta. L.R. 12, reversing 10 W.L.R. 267 (C.A.); The original insurer cannot reinsure a risk it has not assumed. *Commonwealth Ins. Co. v. Globe Mut. Ins. Co.* (1860), 35 Pa. 475, 11 Casey 475.

[9] *Delaware Ins. Co. v. Quaker City Ins. Co.* (1859), 3 Grant Cas. 71.

[10] *Commercial Standard In. Co. v. Fidelity Union Ins. Co.* (1942), Tex. An. App., 157 S.W.(2d) 663.

[11] See chapter II of this thesis.

[12] See chapter II of this thesis.

[13] Lord Blackburn in *Brownlie v. Campbell* (1880), 5 App. Cas. 925, 954.

the latter case the original insurer being himself the assured.[14]

The same principles concerning misrepresentation and concealment govern in the case of reinsurance as in the case of original insurance.[15] In order to refuse liability, the reinsurer must establish the materiality of the misrepresentation or the intentional concealment or bad faith in concealing the facts.[16] A simple non-disclosure of facts possibly known will not necessarily be an unfavourable circumstance to the claim of the insurer since both –insurer and reinsurer– are supposed to be experts on insurance and it is not considered as a fraudulent concealment.[17] However, as in the case of insurance, the proposer (the reinsured) has the main duty of disclosure because the underwriter knows nothing and the proposer knows everything.[18]

As Golding states, the following facts should be disclosed by the reinsured:

1) All the information possessed by the reinsured related to the risk on which reinsurance is requested.

2) All the information as to the amount retained by the reinsured (the amount the insurance company will insure by itself) on the risk on which reinsurance is requested.[19]

The insurance company cannot allege as defence the fact that the original insured supplied it with incorrect or inadequate information.[20] It is supposed to know all the facts that in the ordinary course of its business it ought to know.[21] The reinsurer may presume that the original contracts of insurance are subject to the terms and conditions usually applicable to them and the insurance company must disclose any unusual omissions or additions.[22]

The misrepresentations made by the insured in the original insurance contract can invalidate the reinsurance in the following situations:

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[14] *Federal Ins. Co. v. Westchester Fire Ins. Co.* (1929), 3 W.W.R. 646; 24 Alta.L.R. 330; 1 D.L.R. 525 (C.A.).
[15] *General Reinsurance Corp. v. Southern Sur. Co. of Des Moines* (1928), Iowa C.C.A. 27 F.(2d) 265.
[16] Ibid.
[17] Ibid.
[18] Scruton L J in *Rozanes v. Bowen* (1928), 32 Ll.L.R. 98.
[19] C.E.Golding, The Law and Practice of Reinsurance, p.9.
[20] *Equitable Life Assurance Soc. v. General Accident Assurance Corporation* (1904), 12 S.L.T. 348.
[21] *London General Insurance Co. v. General Marine Writer's Association* (1921), 1 K.B. 104.
[22] *Charlesworth v. Faber* (1900), 5 Com. Cas. 408.

1) If the original insured makes incorrect statements which are warranted true in the policy and are stated to constitute the basis of the reinsurance contract.[23]

2) If the original insurer adopts its insured's statements and warrants their accuracy at the time the reinsurance is effected.[24]

The duty of good faith of the insurance company in relation to the facultative reinsurance is similar to that of the primary insured. The business is normally offered to the reinsurer in a slip, on which all the material particulars of the risk must be shown, including:

1) Details of any losses incurred by the insurance company on that business. Ignorance of the details or the significance of loss experience is no excuse for non-disclosure where the relevant facts are either already in the possession of, or are available to, the insurer.[25]

2) The insurace company's prospective retention. If the insurer, before the reinsurance contract is concluded, varies its intention as to the proposed retention, it must disclose that fact.[26]

In the case of reinsurance treaties, the duty of good faith varies. The purpose of treaties is to relieve the insurance company from submitting details of each particular risk. Under proportional reinsurance treaties, (a proportional treaty is a contract under which the reinsurer shares a percentage of each risk ceded, receives an equal percentage of the original premium and pays the same percentage of any loss),[27] the reinsurer receives little or no information about the risks ceded. Under non-proportional treaties, (a non-proportional treaty is a contract in which the reinsurer pays the losses in excess of an agreed amount retained by the insurer and up to a established limit),[28] the reinsurer has no direct interest in the individual risks. In all other respects, the duty of utmost good faith remains. This duty is expressed by Golding:[29]

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[23] *Australian Widows Fund Life v. National Mutual Life Association of Australia Ltd.* (1914), A.C. 634.
[24] *Foster v. Mentor Life* (1854), 3 E.& B. 48. Part of the court in this case considered this declaration as simply informing the reinsurer of the declaration which formed the basis of the original policy.
[25] *London General Insurance Co. v. General Marine Underwriters' Association* (1921), 1 K.B. 104; 4 LI.L. Rep. 382 and *General Accident Fire and Life Assurance Corporation Ltd. v. Campbell* (1925), 21 LI.L. Rep. 151.
[26] *Trail v. Baring* (1864), 33 L.J. Ch. 521.
[27] See Chapter III of this thesis.
[28] See Chapter III of this thesis.
[29] Golding, Law and Practice of Reinsurance, p. 10.

> The ordinary rule as to disclosure of material facts operates only up to the time the contract is concluded, but it may be submitted that under a treaty something more may be required. The mere completion of the contract is but the beginning, not the end, of the reinsurance operations which are contemplated thereunder. Every time a cession is made under a treaty, this initiates an actual reinsurance, and though the details which have to be communicated to the reinsurer are limited, yet in the general operation of the treaty, the ceding company is bound to exercise the utmost good faith towards its reinsurer, even though this must occur after the contract was completed.

Therefore, the duty of the reinsured is to act honestly and not to attempt to cheat its reinsurer by making fraudulent claims or by deliberately provoking a loss.[30]

Indemnity

The principle of indemnity applies to all contracts of reinsurance. The liability of the reinsurer depends on the loss the insurance company has suffered, subject to the limits set out in the contract.[31] In order to claim under a reinsurance contract, the insurer must establish that the loss is covered by it and that it was liable to pay for it.[32] Therefore, if the reinsured makes an ex gratia payment[33] without express authorization from the reinsurer, it will not recover that amount.[34] Likewise, if the reinsured incurs costs for resisting or defending a claim for which the reinsurer would otherwise be liable, it does not have the right to recover unless the reinsurer has consented.[35] However, where an original liability policy contained a clause indemnifying the original insured against costs incurred in defending a claim and entitled the insurer to take over the defence of the insured, the reinsurers who had reinsured the 'liability under the policy' were held liable to indemnify the original insurer for costs incurred.[36] In the case of *Excess Insurance Company Ltd. v. Mathews*,[37] the contract contained a clause which read: "and to pay as may be paid thereon and to follow their settlements". Branson J. held that the words "to

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[30] R.L.Carter, Reinsurance (Middlesex, Great Britain: Kluwer Publishing Company, 1979), p. 127.
[31] *Hone v. Mutual Safety Insurance Co.*, 3 N.Y. Super 137; affd. 2 N.Y. 235.
[32] *Scottish Metropolitan Insurance Co. v. Groom* (1924), 10 T.L.R., 676.
[33] A payment which the ceding company is not obliged to do, but nevertheless, is done.
[34] In the case of *Chippendale v. Holt* (1924), 40 T.L.R. 676, it was held that the term in the reinsurance contract 'to pay as may be paid thereon' should be construed to mean 'to be properly paid thereon'.
[35] *British General Insurance Co. v. Mountain* (1919), 1 Lloyd L.R. 605; 36 T.L.R. 171.
[36] 'Compromise Settlement', Reinsurance, July 1970, quoted by R. L. Carter, Reinsurance (Middlesex, Great Britain: Kluwer Publishing Company, 1979), p.129.
[37] (1925), 31 Com. Cas. 43.

follow their settlements" extended to cover compromise settlements where the liability of the primary insurer was in doubt. In practice, if the reinsurance contract has a "follow the fortune" clause clear and wide enough to cover these situations, the ceding company will be covered. The purpose of such a clause is to bind the reinsurer to any bad or good fortune experienced by the insurance company.[38] If the insurer is to have power to bind the reinsurer for ex gratia or any other unusual type of payments made, this power has to be expressly conferred by the terms of the contract.

An example of a provision that gives such power is the following:

> The ceding company has the sole right to settle claims either by way of compromise, "ex gratia" payments, or otherwise, and all settlements are binding on the reinsurer. The reinsurer should be liable for its share of any costs incurred in resisting or defending any claim.

There are three possible ways of interpreting the timing and extent of the reinsurer's liability, depending on the wording of the contract:[39]

1) As a contract of indemnity against actual payment by the reinsured. The reinsurer is not liable to pay until the insurance company has already paid its insured.

2) As a contract of indemnity against liability, in the sense that the liability is the final amount for which the ceding company settles a claim regarding the insurance policy. The reinsurer must pay when the final settlement is reached or the ceding company has been found liable to make payment by a legal process.[40] The insurance company has the right to receive the payment of the reinsurance proceeds, even if it never pays its insured the agreed sum.

3) As a contract to pay on the happening of a contingency. The reinsurer has to pay as soon as the contingency occurs, even if the insurance company suffers no loss or later negotiates a reduction of the amount of loss.[41]

Since the reinsurance contract is one of indemnity, it is also subject to the principle of subrogation. According to this principle, the reinsurer is entitled to recover its share of

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[38]'In the opinion of the writer, their intention is to set up a kind of partnership in treaty matters, so that whatever fortune, good or bad, should befall the ceding company, should be shared by the reinsurer and whatever the ceding company should decide to do in relation to any treaty matter should be equally binding on the reinsurer, even though it had not been consulted. This would clearly cover such things as mistakes or omissions in ceding, contesting of claims or making *ex gratia* payments and compromises of all kinds, which the ceding company may see fit to make with its own insured'. Golding, "Follow the Fortune", Reinsurance, October, 1971.

[39]"Contracts of Indemnity," Reinsurance, August 1969.

[40]*Re Eddystone Marine Insurance Company* (1892), 66 L.T.R. 370; 2 Ch. 423.

[41]*Re Law Guarantee & Accident Society Ltd., Godson's Claim* (1915), 1 Ch. 341.

any amount recovered by the reinsured from anyone primarily responsible for the loss. Those recoveries may come from rights to subrogation exercised by the insurer[42] or by contributions arising from the loss.[43] The American courts have also held that a reinsurer not only has 'an interest in the disposition of salvage but also a right to ask that it be prudently and carefully managed by the insurer'.[44] If the ceding company incurs any reasonable expenses in pursuing its subrogation rights, it is entitled to deduct the expenses from the resulting sum it recovers for the benefit of the reinsurer.[45]

The reinsurer's right to share in any recovery that reduces the loss of the ceding company is limited to the amount reinsured under the original insurance.

B. Elements of the Contract of Reinsurance

The elements of the reinsurance contract are the same as those of the insurance contract.

1) The premium: It is the price the insurance company must pay to the reinsurance company in order to be covered. As in the contract of insurance, actual payment of the premium is not always necessary to create a binding contract of reinsurance.

2) The risk: It is the possibility that a fortuitous event may happen, causing a loss for the insurance company (the reinsured) and, therefore, for the reinsurer. The reinsurance company assumes the risk of being liable when the insurance company has to pay due to the occurrence of a loss covered by the original insurance contract.

3) The insurable interest: This point has already been discussed earlier in this chapter. It is only necessary to add that both the insurance and the reinsurance companies are interested in the non-occurrence of a certain event which would cause losses for them.

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[42] *Assicurazioni Generali di Trieste v. Empress Assurance Corporation* (1907), 2 K.B.L.R. 814; *Universal Insurance Co. v. Old Time Molasses Co. et al*, 46 Fed. (2d) 925.
[43] *Union Marine Insurance Co. v. Martin* (1886), 35 L.J.C.P. 181.
[44] *Maryland Casualty Co. v. City of Cincinnati et al.* 291 Fed. 825.
[45] *Assicurazioni Generali di Trieste v. Empress Assurance Corporation* (1907) 2 K.B.L.R. 814.

C. Parties to a Reinsurance Contract

1) The reinsurance company: There are two kinds of reinsurers: the professional reinsurers and the insurance companies themselves. The professional reinsurer is restricted to writing reinsurance only. An insurance company may also write reinsurance in the classses of business for which it is licenced.

The reinsurance company may also buy reinsurance in addition to supplying it. If the reinsurer desires to reduce its liability on cessions accepted, it will cede part of its liability to another reinsurer. The reinsurer that accepts such cessions is called a retrocessionaire and the cessions are called retrocessions.

2) The insurance company, ceding company or reinsured: The insurance companies are the main buyers of reinsurance. The insurers retain part of the risks they have accepted from the original insureds and cede the rest to the reinsurers in exchange for the payment of a premium. As mentioned before, the insurance companies may also provide reinsurance.

3) Brokers: There is no universally accepted definition of a reinsurance broker.[46] The term is usually used to describe individuals who act as intermediaries in the arranging of reinsurance contracts and as agents for ceding companies or as agents of reinsurers. The remuneration of the brokers consists of an intermediary commission, usually payable by the reinsurer on the amount of the premium.

The role of the broker is to advise his client on all the technical aspects of reinsurance and to arrrange for the contract to be made in a competitive market. However, some brokers, in addition to arranging reinsurance, accept and undertake reinsurance contracts for and on behalf of their principals.

The brokers are effective in placing risks that require the mobilization of a large part of world-wide reinsurance capacity (such as catastrophe covers) and for placing special covers.

There is another type of intermediary who is independent of both the reinsurer and the reinsured. He operates in a separate enterprise as an independent contractor whose

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[46]R. L. Carter, Reinsurance (Middlesex, Great Britain, Kluwer Publishing Limited: 1979), p. 122.

functions are to advise in everything concerning reinsurance requirements and needs, to bring the two parties together, and to assist in the negotiation and consummation of reinsurance contracts. He may also be the contact between the parties, and all reports, payments and communications are transmitted through him. Unlike primary insurance agents and brokers, the reinsurance intermediary usually needs no license from the state.

It is essential to determine whether the intermediary is the legal agent of the reinsurer or the reinsured and whether either is responsible for the actions of the intermediary. The answer to this question was given by the courts in the case of *State v. Pritchard*.[47] In this case, the broker, Pritchard, P&B, was the intermediary between the reinsurer and insurer, underwrote business for the reinsurer, handled the accounts for both parties and transmitted the funds between reinsurer and insurer and vice-versa. The court applied the principle of agency and held that the intermediary was the agent of the reinsured, since the reinsured alone had the power to control the intermediary. Having found an agency relationship, and in view of the acquiescence by both parties in P&B's handling of accounts, reports and transmittal of funds, the court concluded that these activities were within P&B's authority from its principal. Therefore, the reinsured was responsible for any mishandling of the funds by P&B. However, this decision has been criticized because the facts do not support the conclusion.

> The Court took the view that because the intermediary could not act on behalf of the ceding company, the intermediary was controlled by the ceding company and therefore was its agent. By the same reasoning process, the court could have held the precise opposite: that the intermediary was the agent of the reinsurers since the intermediary had to clear terms, conditions, commissions and limits with reinsurers as well as with the ceding company. The intermediary was controlled by reinsurers as much as it was controlled by the ceding company. In the view of many, the fact that the intermediary could not act on behalf of the ceding company should have suggested to the court that the intermediary was not an agent of the ceding company. By the same reasoning, the court could have held that the intermediary was not an agent of either.[48]

Professor John Sheffey suggests three approaches for different situations in which intermediaries are involved.[49] The first one is to place the loss on the party who created the situation and who, in the exercise of reasonable care, might have avoided the loss.[50]

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[47](1979), N. J. Super. 578, 412 A.2d. 1335, 1337 n.5.
[48]R. Strain, Reinsurance, 1980, p. 11 and 343.
[49]In "Reinsurance Intermediaries: Their Relationship to Reinsured and Reinsurer", Forum, vol. 16, 1980-81, pp. 922-941.
[50]This approach was used in *Vera Democrazia Soc. v. Bankers Nat'l Life Ins. Co.*, 10 N.J.M. 632, 160 A. 767 (1932).

For example, the knowledge by one party of the dishonesty of managers in the intermediary firm can place the party in a position of culpability. The second is the allocation of the loss to one party where only one of the parties intends to be at risk. For example, the intention and normal expection in a pure fronting business (where an insurer does business indirectly in jurisdictions in which it is not licensed by having a licensed insurer issuing the primary policies and then reinsuring the entire exposure on all the policies) is to have all losses born entirely by the reinsurers.[51] The third one is that if the court is unable to find which of the two parties is responsible for the loss or even which one bears greater blame, the sole fair result is to divide the loss equally between them.

D. Nature of the Contract of Reinsurance

Facultative contracts of reinsurance are clearly contracts of insurance.[52] Difficulties arise with treaties, since there is no consensus as to whether they are contracts of insurance or not.[53] In the case of *Re Norwich Equitable Fire*[54] it was held that the treaty in question was a contract of agency between the reinsurer and the ceding company. In an American decision it was held that:

> A reinsurance treaty is merely an agreement between two insurance companies whereby one agrees to cede and the other to accept reinsurance business pursuant to the provisions specified in the treaty. Reinsurance treaties and reinsurance policies are not synonimous: reinsurance treaties are contracts for insurance and reinsurance policies or cessions are contracts of insurance.[55]

J. S. Butler, legal correspondent of <u>Reinsurance</u>, has suggested a distinction between three particular situations:

1) Open covers which are only an agreement to make future contracts of reinsurance.[56]

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[51] *Foremost Life Ins. C. v. Department of Insurance*, 395 N.E.2d. 418 (Ind. App. 1979), vacated, 409 N.E.2d. 1092 (Ind. 1980).
[52] See chapter II of this theseis.
[53] See chapter II of this thesis.
[54] (1887) 3 T. L. R. 781.
[55] *Pioneer Life Insurance Co. v. Alliance Life Ins. Co.*, 30 N. E. 2d 66, Ill. 576.
[56] See chapter II of this thesis.

2) Treaties under which the ceding company has to take some action before its policies are reinsured. For example, the ceding company may have to cede surplus lines before the reinsurance comes into effect.

3) Quota share and non-proportional reinsurance treaties where the risks accepted by the ceding company are automatically reinsured.[57]

According to Butler, only the last type would qualify as a contract of reinsurance per se. In his opinion, the first two types would be contracts to enter into contracts of reinsurance. The contracts of reinsurance would be effected when the cessions were made.

E. The Subject Matter of Reinsurance

The subject matter of indemnity insurance is the payment of money. The subject matter of insurance is the thing insured (a house, a car).[58] The courts have invariably held that the subject matter of the reinsurance contract is the same as the insurance contract.[59] However, it is respecfully submitted that the subject-matters differ. According to the authority of *Rayner v. Preston*, the subject matter of the contract of reinsurance would be the liability that the ceding company has under the original insurance contracts, because it is that liability that the insurer is protecting. The subject matter of the policy of reinsurance would be the payment of money, since reinsurance is a contract of indemnity.

A differentiation concerning the subject matter of the contract of reinsurance has been suggested:[60]

1) Facultative reinsurance contracts which are worded in such a way that it can be taken that the subject matter of insurance of the original policies is described as the subject matter of the contracts of reinsurance.

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[57]See chapter III of this thesis.
[58]*Rayner v. Preston* (1881), 18 Ch. D. 1 (C.A.), p.9.
[59]*Glasgow Assurance Corporation (Liquidators) v. Welsh Insurance Corporation* (1914) S. C. 320; *Forsikringsakabet National (of Copenhagen) v. Attorney General* (1929), 93 L. J. K. B. 679 and (1925) A. C. 639.
[60]'Looking at the Reinsurance Contract', Reinsurance, April 1972.

2) Proportional treaty reinsurance contracts which are so ambiguously worded that they can be construed as defining the subject matter of the original policies as the subject matter of the reinsurance treaties.

3) Non-proportional treaties whose wording does not permit the former constructions. It is the possible liability of the ceding company toward its assureds which is actually defined as being the subject matter of reinsurance.

F. Necessity for Reinsurance

The reasons why the insurance and reinsurance companies reinsure their risks are the following:

1) Capacity and distribution of risk: Reinsurance allows insurers to accept risks with larger exposures than they would be otherwise willing to handle. The insurers set an amount they will retain and cede the exceeding amount to the reinsurer. By setting their 'net retention', the insurers are able to control the average size of each exposure without having to decline the acceptance of a risk. As a consequence of a greater capacity, the insurers will be better able to spread or distribute the risks. The reason for this is that insurance is based upon the "law of averages". While the loss on a single risk cannot be foreseen, the total losses on all risks may be predicted with sufficient accuracy to make insurance possible.

2) Financial assistance: Insurers are required by law to keep a surplus of assets to provide for liability on the unearned portion of premiums written and also for excessive losses that may be incurred. The insurance company is able to reduce the required reserve by reinsuring a portion of the business. The premiums paid to the reinsurer would be deducted from the reserves. The insurers may also receive a commission from the reinsurer for acquiring new business. As a result of the commissions paid by the reinsurer and the sharing of operating costs, the insurer may obtain a profit.

3) Catastrophe protection: An insurer has to be prepared to bear the danger of large or multiple losses (for example, losses caused by an earthquake). Reinsurance is the

means to obtain protection and to spread the risk throughout the world (by virtue of the retrocessions entered into by the reinsurers).

4) Stability: The insurer desires to maintain a certain degree of stability from year to year. There is a special type of reinsurance that spreads the losses of a bad year over a number of years. Even if there are underwriting losses, they will be within more manageable proportions.

5) Withdrawal from business: When an insurer wishes to retire from business totally or partially or from a territory or is required to cease operations, it may transfer its liabilities to a reinsurer for a consideration. The consideration will consist of a large part or all of the insurer's reserve. If this is not enough, the insurer will pay capital as well. In case the consideration is not sufficient, the policy holders will not receive all the indemnity they are entitled to.

6)Evaluation of risks: Small insurance companies may not be able to accept unusual risks because they do not have the necessary underwriting experience to assess them. If they submit part of such risks to reinsurers, they may obtain the advice of more experienced companies. By these means, small companies are able to accept unusual hazards.

III. Methods for Placing Reinsurance

There are four methods by which reinsurance contracts may be placed: facultative, open cover (or facultative obligatory), treaty and pool.

A. Facultative Method

The facultative method is the method whereby the insurance company makes a proposal for reinsurance when it wishes to do so, and the reinsurer is able to determine whether or not to accept the proposal. The facultative method is used to reinsure individual risks in four situations: (a) when they would not be attractive to reinsurers if offered on a treaty basis; (b) when they would not be covered by the existing treaties; (c) when the sum insured exceeds the treaty limits or (d) when the ceding company does not want to cede them because of their potentially destabilizing effects.

Under the facultative method, the reinsurer can judge the risk and elect whether to accept it or not and the insurer has the freedom to cede the risk if it desires to do so and to determine the proportion to be ceded. However, this method has three important disadvantages:

1) The procedure for placing facultative reinsurance is delayed because each contract must be negotiated individually. The ceding company or its broker prepares a slip containing all the details of the risk and the retention of the insurer. The reinsurer receives the slip and decides whether to accept the risk. If it decides to accept, it will initial the slip, indicating the proportion of the risk that it will take. The reinsurer's liability commences when the slip is initialled, but reinsurers may backdate their cover, provided no loss is known to have occurred. The ceding company issues a 'request note', describing again briefly the details of the risk. The reinsurer sends a 'take' note, formally accepting the reinsurance. This long process has been shortened, and the last two documents are combined in a single 'offer and acceptance note' issued by the insurer in duplicate, which the reinsurer signs and returns one copy to the insurer.

2) The administrative costs for both parties are higher than for treaty reinsurance because of the long process involved in the negotiation, whereas in treaty reinsurance the

risks are reinsured automatically. In addition, the commissions paid to ceding companies for giving reinsurers business are low or may not exist at all.

3) Usually facultative reinsurance is accepted for only one year. It needs to be renewed each year and each time the original insurance is renewed. Therefore, there is a danger that insurance companies will overlook the necessity to place or to renew facultative reinsurance.

B. Treaties

The treaty is an agreement (usually in writing) between a ceding company and one or more reinsurers, whereby the ceding company agrees to cede and the reinsurers agree to accept the reinsurance of all the risks written by the ceding company which are covered by the treaty and within the limits specified in it. In this way, as soon as the insurer has accepted a risk covered by the treaty, it will have automatic reinsurance, subject to the limits set out in the treaty.

A treaty will be negotiated when the volume of business ceded is enough to spread all the risks, making it economical for the reinsurer (and facultative reinsurance would be uneconomical).

Treaties are less expensive than facultative reinsurance to operate, because each risk is ceded automatically without negotiation. For the ceding company, treaties have the advantages of easy handling and the certainty of reinsurance for the risks accepted. The reinsurer has the advantage that it is sure of receiving a substantial volume of business. Because the reinsurer will receive a wider spread of the ceding company's business, the reinsurance premium will be lower.

However, treaties have their disadvantages. The first one is that the reinsurer has to operate in 'blind' relation to the accepted risks. In the past, insurers used to send detailed bordereaux to the reinsurers, informing them of all the risks ceded and their specifications, but this practice has disappeared because of the great number of reinsurance contracts covered by the reinsurance treaties. Without the knowledge of the specific risks involved and their characteristics, the reinsurer can only look to past experience with the ceding company to assess the advantages or disadvantages of a

particular treaty. The second disadvantage is that the reinsurer loses its right to select the business it accepts: it must reinsure the good and the bad.

C. Open Covers and Facultative Obligatory Arrangements

Facultative obligatory arrangements are agreements whereby the reinsurer is bound to accept all reinsurances offered by the insurer, but the ceding company has no obligation to make any offer. When these agreements are entered into by a broker and a reinsurer, they are called open covers. The reinsurer sets a limit for its acceptance and specifies the types of risks it will accept.

This method is of advantage to the insurer because it will have automatic reinsurance when it wants to. The disadvantage to the reinsurer is that it is bound to accept what it is being offered and cannot exercise its judgment and skill in assessing the risks. As a consequence, the portfolio of ceded business tends to be less balanced. When the ceding company has various facultative obligatory agreements in force with different reinsurers, there is no order in which they may be used and there is the possibility of an adverse selection against certain reinsurers. This method is not widely used because of the negative consequences for the reinsurer.

D. Reinsurance Pools

Pools are organizations in which each participating company may subscribe part of the capital required to establish a separate reinsurance corporation. This reinsurer will reinsure some agreed part of the risks underwritten by the companies and it may also retrocede (reinsure the reinsurance contracts) part of the risks back to the member companies. The pool may be formed for specific hazardous risks or may be formed for general risks. Its operations can be restricted to a certain territory or may be extended to include operations of members from many countries.

IV. Types of Reinsurance

All reinsurance is proportional or non-proportional. Under proportional reinsurance, the reinsurer accepts a fixed share or proportion of the liabilities assumed by the insurer. Under non-proportional reinsurance, the reinsurer becomes liable to pay if the losses of the ceding company exceed an agreed amount and up to a limit. Proportional reinsurance was developed as a variant of coinsurance, in which a number of insurers share the direct insurance.

A. Pro-Rata or Proportional Reinsurance

Under proportional reinsurance, the reinsurer agrees to share a stipulated percentage of each risk ceded, is entitled to receive the same percentage of the original premium paid to the insurer, and must pay the same percentage of any loss. In addition, the reinsurer pays the insurer a commission for the costs of acquiring the business. The commission is deducted from the premium that the insurer must pay the reinsurer. For example, if the insurer cedes 80% of a risk, the reinsurer will receive 80% of the premium (less the commission payable to the insurer) and will pay 80% of the losses that may occur.

Proportional reinsurance may take three forms: quota share, surplus and combined quota-share and surplus reinsurance. The method for placing reinsurance called treaty will be used to explain how these types of reinsurance work, since it is the most widely used.

Quota-share treaties

This type of treaty is the simplest one. The reinsurer agrees to reinsure a fixed proportion of every risk accepted by the insurance company. In return, the reinsurer will receive the same fixed proportion of the premium (less the commission) and will be liable to pay the same proportion of all losses that fall within the treaty. The treaty will specify which classes of risks it covers, the monetary limits, the geographical area and any other

type of restrictions. For example, the reinsurer may agree to reinsure 80% of certain risks accepted by the ceding company, up to a limit of $100,000 per risk. The insurer will retain 20% of the premium and will pay to the reinsurer 80% of it. If the risk occurs, the insurer will pay 20% of the losses and the reinsurer 80%.

This type of reinsurance is commonly used when new companies are beginning to operate as insurers or when they enter into a new class of business unknown to them.

The advantages are simplicity and cheap administration. Also, the ceding company can accept risks with the assurance that they will be automatically reinsured to an acceptable limit. Since the reinsurer will receive a wider spread of risks, it is able to charge less and pay a higher commission. The premiums of reinsurance are also deductible from the retained premium income. The insurer can use this facility in order to continue to meet a prescribed ratio of net income to capital and free reserves.

This type of reinsurance also has disadvantages. The main one is that the ceding company is obliged to cede an equal proportion of every risk it accepts. This is disadvantageous because the insurer cannot elect which risks to retain and has to cede proportions it could handle by itself. In order to avoid this situation, the insurer will reduce the proportion of cessions when it has built up its premium income and reserves.

<u>Example of how a quota-share treaty works</u>

Amount insured: $100,000.

Amount ceded to reinsurer: $80,000. (80%)

Amount retained by insurer: $20,000. (20%)

Rate for insurance premium: 0.040.

Insurance premium: $400.

Premium for insurer: $80. (20%)

Premium for reinsurer: $320. (80%)

If there is a loss for $50,000. (50% of insured amount):

--the reinsurer will pay $40,000. (80%)

--the insurer will pay $10,000. (20%)

Surplus treaty

The surplus treaty is a proportional reinsurance whereby the reinsurer agrees to accept a proportionate share of a risk and the reinsured pays the same proportional share of the premium received. The difference between quota-share and surplus treaty reinsurance is that in the latter, the ceding company is able to determine its own retention for each kind of risk and cedes only the surplus. The advantage for the ceding company is that it can decide what percentage of liability it will cede for each individual risk. In practice, insurance companies will have their tables of limits for each type of risk. The insurer will retain a small risk completely and will cede a big part of a larger risk.

In a surplus treaty, the amount retained by the insurer, called a 'line', will be related to the amount it will be able to cede. The reinsurer will determine the amount the insurer can cede according to insurer's retention. The larger the retention of the insurer, the larger the cession to the reinsurer can be. The maximum amount that the insurer is able to cede will be restricted to "'x' number of lines".

Surplus treaties will contain clauses concerning the classes of business covered, the territorial limits and any other limitation and the extent of the reinsurer's liability for each risk.

The disadvantages are that the reinsurer will receive a portfolio with a narrower spread of business (because the insurance company will retain the low-risk business) and that the reinsurer has little information about the risks accepted (it does not receive bordereaux detailing the risks ceded). As well, the costs of administering such treaties are higher.

Example of how a surplus treaty works:

In a six-line treaty, (the line being defined as the reinsured's own retention), the reinsurer's liability will be six times the amount retained by the insurance company.

Amount insured: $100,000.

Retention of insurer: $20,000.

Surplus reinsurance: up to 6 lines (This means that the reinsurer will be liable to pay up to six times the net retention of the insurer, which is equal to $120,000). The reinsurer will receive a predetermined proportion of the premium of every risk that is reinsured and if

any loss occurs, it will pay the same proportion of the loss, but subject to the maximum limit of $120,000.

When the amounts to be reinsured are large, the amount can be divided in different surplus treaties. For example, the first surplus treaty would cover the first $120,000 of losses. The second would cover the losses from $120,000 up to $500,000 and so on. The second or third surplus agreement would be operative when the preceding treaty would have been filled to its capacity. These treaties are used for extending the capacity of the ceding company. The commission paid to the insurer for the second, third, etc. surplus treaties is less favourable as the one paid for the first surplus treaty, since the reinsurer receives a narrower spread of business.

Combined quota-share and surplus reinsurance

These treaties provide quota-share reinsurance for the insurance contracts of certain class accepted by the ceding company, plus a surplus reinsurance on the rest of its gross line. The premium payable to the reinsurer is calculated according to the ceded proportion. Newly established companies use these treaties in order to increase their underwriting capacity. When such companies build up their reserves, they will gradually decrease their quota share reinsurance.

<u>Example of how a combined quota-share and surplus reinsurance works</u>:

Amount insured: $100,000.

Limit of the quota-share contract: $50,000. (This figure is called gross line of $50,000).

Retention of the insurance company for the quota-share treaty: $20,000. (20%)

Amount ceded to the reinsurer in the quota-share treaty: $30,000. (30%)

Surplus treaty: A three-line surplus reinsurance for amounts in excess of the ceding company's gross line of $50,000. (This means that the surplus reinsurance will cover losses for $150,000, total which is equal to three times the gross line of $50,000).

If a loss for $100,000 occurs, the ceding company will pay $20,000, which corresponds to its 20% retention under the quota-share treaty. The reinsurance company will pay $30,000 which corresponds to its 30% share under the quota-share treaty. Under the surplus reinsurance treaty, the reinsurer will pay $50,000.

If the loss is for $80,000, the ceding company pays $20,000 and the reinsurer $30,000 under the quota-share treaty. Under the surplus treaty, the reinsurer will pay the remaining $50,000.

Main elements of reinsurance contracts

All reinsurance contracts (proportional or non-proportional) contain certain common elements which include:

1) The details of the two parties.

2) The commencement day of the contract. In the case of a treaty, there must be no doubt regarding the commencement of the liabilities assumed by the reinsurer. Care must be taken in order to avoid a gap in or an overlapping of the cover provided by the new treaty and the treaty or facultative reinsurance it replaces. In the case of a facultative contract, it has to be specified whether the reinsurance cover begins the same date the original insurance does or at some other time.

3) An operative clause defining the form of reinsurance; the classes of insurance covered; the geographical area from which the business is obtained and the monetary

limits.

4) The risks not covered by the contract of reinsurance (exclusions).

5) A premium clause specifying the basis on which reinsurance premiums shall be calculated.

6) A commission clause stipulating the commission to be paid to the reinsured, if any.

7) A claims clause dealing with the notification of claims to the reinsurer and their payment.

8) An accounts clause dealing with the preparation and settlement of accounts.

9) An arbitration clause stipulating the procedure to be followed in the event of any dispute.

10) A termination clause dealing with the circumstances that will end the contract.

11) A currency clause specifying the currency in which premiums and losses are to be paid and the rates of exchange used for settlements, when the contract is made between companies from different countries.

<u>Rights and obligations of the parties under proportional reinsurance contracts</u>

Contracts of reinsurance may vary from company to company. However, in most of the cases, they are similiar and the rights and obligations the same.[61]

Rights and obligations of the reinsured:

1) If there is an express agreement, the reinsured may reduce the amount to be ceded by effecting a facultative contract of reinsurance with another reinsurer. In this case, the reinsured will only cede the amount not covered by the facultative contract.

2) The reinsured shall define the limits of the risks which it agrees to assume and the extent of its liability.

3) The reinsured may request immediate payment from the reinsurer of its proportion of any losses up to the maximum agreed amount.

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[61]In order to make this analysis, the reinsurance contracts taken as basis are from the Mercantile and General Reinsurance Company of Canada.

4) The reinsured shall cede the proportion of business agreed upon, in the absence of further agreement.

5) Under surplus treaties, the reinsured shall fix the amounts it wishes to insure by itself (the insurer's retention) and the amounts it wishes to reinsure. In the event the reinsured wishes to retain on a particular risk a different percentage than what it undertook to retain, it must get the approval of the reinsurer.

6) The reinsured shall not modify its acceptance and underwritin policy related to the ceded business without prior approval of the reinsurer.

7) The reinsured shall record all cessions and their renewals and alterations on a bordereau form.

8) The reinsured shall pay the agreed premium for the risks ceded.

9) The reinsured shall advise the reinsurer of any potential claim which equals or exceeds the amount agreed upon, together with the relevant details and an estimate of the probable costs.

10) The reinsured shall keep the reinsurer informed of developments of the claims and shall consult the reinsurer with regard to those claims, to the extent it reasonably can.

11) The reinsured shall record all losses paid under the agreement on a bordereau form.

12) The reinsured shall send to the reinsurer from time to time a statement of unsettled claims for which the reinsurer may be liable.

13) On request of the reinsurer, the reinsured shall supply copies of policies, records or documents of any kind relating to business covered by the agreement.

14) The reinsured shall comply with all the rules of rendering, confirming and paying the accounts as stipulated in the contract.

Obligations of the reinsurer:

1) The reinsurer shall accept the proportion of risks agreed upon ceded by the reinsured.

2) The liability of the reinsurer shall be subject to all the stipulations, clauses, waivers and modifications of the original policy.

3) The reinsurer shall allow the commission stipulated in the contract to the reinsured for acquiring business.

4) The reinsurer shall pay its proportional share of losses when a risk covered by the treaty occurs, including legal costs, professional fees and expenses.

5) The reinsurer will be liable for the ex gratia payments (not required by law) made by the insurer if expressly provided for in the contract.

6) The reinsurer's authorized representative may inspect all the records and documents relating to the ceded business at any reasonable time.

Rights and obligations of both parties:

1) The parties may agree on alterations to the agreement. Those alterations must be in writing and will be equally binding.

2) Either party shall pay interest on any outstanding amount.

3) Either party may set off any amount due from the other party.

4) The parties may agree that certain or all disputes arising from the reinsurance contract will be settled by arbitration.

5) Either party has the right to terminate the agreement upon giving notice to the other party in accordance with the provisions agreed upon or when certain circumstances occur.

6) Either party shall correct as soon as possible any accidental error or omission related to the premium, claim or contract.

B. Non-Proportional or Excess Reinsurance

In the non-proportional type of reinsurance, the risks are not shared according to a specified proportion but according to an arbitrarily set amount. A non-proportional reinsurance contract is an agreement whereby the reinsurer undertakes to indemnify the reinsured against any loss that exceeds an agreed amount and up to a limit. For example, the reinsurer may undertake to indemnify the reinsured for any loss exceeding $10,000 and up to a limit of $50,000.

The non-proportional reinsurance contract is like a typical insurance contract. The ceding company is responsible for all losses within its retention and the reinsurer is liable for the losses that exceed that retention. To the extent that there is no proportional sharing of risks and premiums, it is not a sharing agreement but a direct insuring contract.

The cost of the reinsurance (the premium the ceding company pays to the reinsurer) may vary from year to year, according to the claims experience, volume and spread of business, the level of the company's retention, the classes of risks and other factors.

The excess reinsurance is often placed in layers. For example, the first layer may cover from $25,000 up to 100,000 and the second from $100,000 up to 300,000 and so on. Each layer or level of exposure has a different rating which is extremely hard to determine.

The advantages of a non-proportional reinsurance contract are:

1) The ceding company can cut off its liability at the chosen monetary limit. As a result, the insurer will have more stability in its results because it is protected against large losses.

2) The ceding company can retain a higher proportion of its premium income because it retains the small risks within its capacity and when it pays the premium to the reinsurer, it is not shared but paid according to a specific rate.

3) Administration costs are lower.

The disadvantages are the following:

1) It is very difficult to fix premiums fair to both parties because it is almost impossible to relate the premium and the expected loss experience. The reinsurer usually relies on the past loss experience, but this method is not useful for calculating premiums for all types of reinsurance.

2) The ceding company receives no commission.

<u>How to determine the liability of the reinsurer</u>:

The intention of the parties is that the reinsurer will pay any loss that exceeds an agreed figure. That agreed figure is called "ultimate net loss." The ultimate net loss will include all recoveries (salvages, underlying reinsurances, exercise of subrogation rights).

The following clause taken as example defines the term "ultimate net loss":

> The term 'ultimate net loss' shall be understood to mean the total amount which the reinsured has actually paid in settlement of all claims or series of claims arising out of any one accident or event which may occur during the period set out in the schedule, including any reasonable legal costs and professional fees and expenses (excluding salaries of all employees and office expenses of the reinsured) incurred in connection therewith. Recoveries including amounts under reinsurances which inure to the benefit of this agreement shall be first deducted from such amount to arrive at the amount of liability, if any, attaching hereunder. Any recoveries effected subsequent to a settlement of any such ultimate net loss shall be applied as if effected prior to such settlement and such adjustment as may be necessary shall be made forthwith. Nothing in this article, however, shall be construed to mean that claims are not recoverable hereunder until the ultimate net loss of the reinsured has been ascertained.
>
> b)The liability of the reinsured hereunder in respect of each ultimate net loss shall not be increased by reason of the inability of the reinsured to recover amounts from any other reinsurer for any reason whatsoever.

It is important to note first that legal fees and other costs incurred in the settlement of claims can be added to the loss, but the reinsurer will benefit from any recovery by way of salvage, the exercise of subrogation rights or contributions from underlying reinsurances. Second, if the ceding company is not able to recover from another reinsurer, the reinsurer's ultimate net loss will not be increased. If there is no provision in the contract excluding the liability of one reinsurer toward the insurance company for losses suffered by reason of the inability of the latter to recover from other reinsurers, that reinsurer would be liable for those losses for which it has received no premium. And third, if the settlement of the claims takes a long period of time and the reinsured has already made payments, the reinsurer shall pay its part even though the ultimate net loss cannot be determined yet.

Non-proportional reinsurance can be divided into two categories: excess of loss and stop loss or excess of loss ratio. Excess of loss reinsurance is further divided into excess of loss cover arranged on a risk basis and on an occurrence basis.

Excess of loss reinsurance

Excess of loss reinsurance protects the reinsured against losses on individual risks or against an accumulation of losses due to a single event.

Excess of loss reinsurance arranged on a risk basis:

This type of reinsurance protects the reinsured against any loss on an individual risk which exceeds a predetermined amount. It does not protect against either an accumulation of losses arising from a single incident (such as a natural disaster), nor from an accumulation of losses occurring in one year. When this type of reinsurance is used as the sole form of reinsurance for a particular class of business, its object will be to protect against large losses that may arise from individual policies. In this case, the reinsurance is called underwriting or working cover. It is called working because the reinsurer expects to be liable for a number of losses each year.

Excess of loss reinsurance arranged on occurrence basis:

This type of reinsurance provides protection against an accumulation of losses due to a single incident affecting more than one policy. This reinsurance is also called catastrophe cover because it protects against losses arising from a catastrophe or a very severe event. For example, this reinsurance protects against the losses caused by an earthquake or tornado.

Both types of excess of loss reinsurance can be layered, that is, splitting the amount to be reinsured into various portions, and paying different rates for each layer. For example, if the sum to be reinsured is $500,000, the reinsurer could divide the amount in three layers: the first layer would cover the first $100,000 and the rate payable for that portion would be 00.04; the second layer would cover from $100,000.01 up to $300,000 and the rate would be 00.065 and the third layer would cover from $300,000.01 up to $500,000 and the rate would be 00.08.

Stop loss and excess of loss ratio covers

This type of reinsurance protects a company when its aggregate annual net loss experience on a particular account exceeds a tolerable amount. The reinsurer will be liable to pay when the annual loss ratio of the ceding company exceeds a safety limit (the annual loss ratio is the ratio of claims incurred to earned premiums or the ratio of claims arising

to premiums written). The retention of the ceding company will vary according to the type of business. For example, an excess of loss ratio reinsurance will cover the losses incurred in excess of 80% of earned premiums up to 125% or up to $1,000,000, whichever is the less. The object of this reinsurance is to protect the ceding company from wide fluctuations in its annual loss experience.

Example of how stop loss and excess of loss ratio covers work:

The ceding company has a treaty whereby the reinsurer will cover losses incurred in excess of 85% of earned premiums up to 120% or up to $500,000, whichever is the less. Therefore, the liability of the reinsurer will be 85%–120% and any excess over 120% is at the expense of the ceding company.

Case where the claims are for less than 120% of earned premiums:

Earned premiums: $500,000.

Claims: $500,000. (100% of earned premiums)

Amount payable by insurer: $425,000. (85% of earned premiums)

Amount payable by reinsurer: $75,000. (15% of earned premiums)

Case where the claims are 120% of the earned premiums:

Earned premiums: $500,000.

Claims: $600,000. (120% of earned premiums)

Amount payable by insurer: $425,000. (85% of earned premiums)

Amount payable by reinsurer: $175,000. (35% of earned premiums)

Case where the claims are more than 120% of earned premiums:

Earned premiums: $500,000.

Claims: $800,000. (160% of earned premiums)

Amount payable by insurer: $625,000. (85% of the earned premiums –$425,000– plus the excess of $200,000 in the claims)

Amount payable by reinsurer: $175,000. (35% of earned premiums)

Rights and obligations of the parties under non-proportional reinsurance contracts

Rights and obligations of the reinsured:

1) The reinsured will determine what constitutes one risk.

2) The reinsured may at its discretion commence, continue, refund, compromise, settle or withdraw from actions, suits and proceedings.

3) The reinsured shall not retain on one risk an amount greater than the amount agreed upon.

4) The reinsured shall pay the premium at the agreed rate.

5) The reinsured shall pay a deposit premium as agreed.

6) After the end of each annual period, the reinsured shall supply to the reinsurer a declaration of its gross net premium income.

7) The reinsured shall notify the reinsurer immediately of each claim on which there is a potential loss which may affect the contract, and provide an estimate of the probable cost of that loss.

8) The reinsured shall not introduce any change in its acceptance and underwriting policies capable of increasing the liability of the reinsurer without its consent.

9) The reinsured, upon request, shall supply the reinsurer with copies of policies, records or documents relating to the contract.

Rights and obligations of the reinsurer:

1) The reinsurer shall be entitled to the benefit of any salvage or recovery before or after the settlement of claims up to the amount paid by it.

2) The reinsurer may inspect any books or documents relating to the reinsurance contract upon giving notice to the reinsured.

3) The reinsurer shall become liable to pay in excess of a certain amount of ultimate net loss on each risk or occurrence.

4) All claim settlements made by the reinsured are binding on the reinsurer. Ex gratia payments made by the reinsured are binding on the reinsurer if expressly provided for.

Rights and obligations of both parties:

1) The parties may make alterations to the contract in writing and those alterations will be equally binding.

2) Any outstanding amounts will be subject to the payment of interest.

3) Either party may set off amounts due from the other party.

4) The parties shall submit to arbitration the disputes arising between them if they provided for an arbitration clause.

5) Either party has the right to terminate the agreement when special circumstances occur or when it gives the agreed notice to the other party.

6) Accidental errors or omissions relating to the contract do not invalidate it and shall be corrected as soon as possible.

V. Special Clauses of the Contract of Reinsurance

Four typical clauses of contracts of reinsurance will be analyzed in this chapter: the index or stability clause, the errors and omissions clause, the termination clause and the arbitration clause. They were chosen because of their significance in the reinsurance industry.

A. The Index or Stability Clause

Inflation is a major problem in the insurance business, but in the area of excess of loss reinsurance it causes its most severe effects. Inflation (devaluation of the dollar's purchasing power) enlarges the claims because the costs of repairing losses have increased. This situation has two effects.[62] First, the reinsurer will be liable for more losses because the claims that would normally be covered by the reinsured's retention now need to be covered by the excess of loss reinsurance. Second, the actual cash value of the insurer's retention is continually decreasing while claim awards are being increased. As a consequence, the insurer is placed in the position of having to pay for the effect of inflation and, therefore, the reinsurer is in the same situation.

The index or stability clause is used to avoid these problems. The index clause is the means whereby the retention of the insurance company (the amount that the reinsured can insure by itself) is adjusted to retain its relative value which exists at the commencement of the agreement. This clause fulfills two functions: it increases the insurer's retention in relation to monetary values and spreads the effect of inflation on long outstanding excess claims.[63]

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[62]David E. Wilmot, Non-Proportional (Treaty) Reinsurance, The Mercantile and General Reinsurance Company of Canada, Limited.

[63]The following is an example of an index clause used by the Mercantile and General Reinsurance Company of Canada, Limited in an automobile and general liability excess of loss treaty:

Indexation Clause

1. It is the intention of this agreement that the stated retention of the company [the reinsured] shall be adjusted to retain its relative value which exists at the commencement of the agreement. Such relative value shall be deemed to be based on the Index of Average Hourly Earnings in Manufacturing Industries issued by Statistics Canada and published in Catalogue No. 72-002 by Information Canada, Ottawa.
2. In respect of claims under this agreement arising from accidents occurring on or after the first day of January ..., the company [reinsured] shall submit a list of payments making up each such claim. The reinsurer shall adjust the amount of each payment to its relative

B. Errors and Omissions Clause

The majority of reinsurance contracts include an errors and omissions clause whereby certain accidental or inadvertent errors or omissions made during the life of the contract shall not prejudice the rights of either party. The scope of the clause can be limited by the wording of the contract itself. For example, it may be limited to errors and omissions related to premiums, claims, cessions and cancellations or it may be more extensive, as when the wording of the contract says 'errors and omissions which are related to the application of the agreement'.

The errors and omissions clause is of particular importance in the reinsurance contract where the principle of utmost good faith plays the major role.

There are different types of errors and omissions clauses. Their scopes of application vary from contract to contract. Three different clauses are given as examples.[64]

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[63](cont'd)value as at January 1, ... by the following formula:
Amount of Payment times Index for January 1, ... divided by Index for Month of Payment equals the Adjusted Payment Value.
To avoid delay in payment of the reinsurer's liability hereunder, the final payment(s) by the company [reinsured] in respect of a claim shall be adjusted in accordance with the last available monthly Index, instead of the Index for the month of payment.
The adjusted retention of the company [reinsured] in respect of such claim shall then be calculated as follows:
Total Actual Payments divided by Total Adjusted Payment Values and this coeficient multiplied by X Stated Retention equals the Adjusted Retention.
Nothing herein contained shall preclude interim payments by the reinsurer in partial discharge of its liability under this agreement. When such interim payments are made, the calculation of adjusted retention shall be deemed provisional and subject to final adjustment when the final payment is made by the company [reinsured].
3. If the Index specified in Section 1 above shall be revalued by Statistics Canada, the necessary recalculations shall be made to re-establish the Index to its form before such revaluation. If such recalculation is not possible, the parties shall select such other comparable Index as they may mutually agree upon.
4. In consideration of the retention adjustments to be made in accordance with Section 2 above, it is understood and agreed that the maximum liability of the reinsurer, under this agreement, in respect of any one accident or occurrence, shall not exceed the limits stated in Article 3, Section 2, nor shall the operation of Section 2 above reduce the adjusted retention below the retention stated in Article 3, Section 1.

[64]The three different clauses are used in different contracts of reinsurance entered into by the Mercantile and General Reinsurance Company of Canada.

The first one applies only to errors or omissions relating to premiums or claims:[65]

> Accidental errors or omissions relating to premiums or claims hereunder, shall not invalidate this agreement but same shall be duly corrected as soon as possible after detection.

The second one applies to more extensive circumstances:[66]

> The company (the reinsured) shall not be prejudiced in any way by any omission through clerical error, accident, or oversight to cede to the reinsurer, any amount rightly falling to them under the terms of this agreement, nor by erroneous cancellation, either partial or total, of any amount ceded, nor by any omission to advise the reinsurer of losses.... and it is agreed that any errors or omissions will be rectified immediately upon discovery.

The scope of application of the third one is the broadest:[67]

> Inadvertent errors and omissions in applying the present agreement shall not prejudice the rights of either party but shall be rectified as soon as possible.

C. The Termination Clause

The majority of reinsurance contracts include provisions concerning three types of circumstances that will cause the termination of the contract: the will of the parties to terminate the contract, the happening of a condition subsequent agreed upon, and the breach of the contract. The first one is the general one: either party may terminate the agreement upon giving notice to the other party. Usually, both parties agree on a notice period which may vary from three to six months. The period of notice during which the reinsurance contract remains in effect is of benefit to both parties. The reinsured will have enough time to negotiate another reinsurance contract and the reinsurance company will be able to plan its activities.

The second circumstance refer to special events, upon the happening of which one party will have the right to terminate the agreement by giving notice in writing. Some contracts stipulate that the notice shall be deemed to be served upon dispatch or, where communications between the parties are interrupted, upon attempted dispatch. Others just stipulate that the affected party shall give immediate advice of the circumstance to the

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[65]Clause used in a automobile and general liability excess of loss treaty.
[66]Clause used in a first surplus property reinsurance agreement.
[67]Clause used in a quota-share treaty.

other one, who shall have the right to terminate the agreement upon the giving of notice in writing to the affected party. The situations which entitle one or both of the parties to terminate the contract include the following:

1) The loss of the whole or any part of the paid-up capital of either party.

2) The bankruptcy, liquidation or receivership of either party.

3) The fact that either company enters into any arrangement by way of shareholding, management or otherwise, under which effective legal or presumptive control is assumed by any individual or organization other than that which pertained at the time the agreement became effective.

4) The reduction by the reinsured of the net retained share of the business reinsured without the previous written consent of the other party.

5) The agreement of either company to any arrangement which would end its separate existence.

6) The decree of an Insurance Department or other competent authority ordering either company to cease writing new or renewal business.

7) The performance of the whole or part of the agreement is prohibited or rendered impossible <u>de jure</u> or <u>de facto</u> and, without prejudice to the generality of the preceding words, in consequence of any law or regulation which is or shall be in force in any country of territory or if any law or regulation shall prevent directly or indirectly the remittance of any payments due to or from either party.

8) War, declared or not, in the country in which either party resides or carries on business or is incorporated.

The purpose of all these sections is to protect the party which is not affected by the unfavourable situation from experiencing future losses due to the position of the other party or to its inability to fulfill the contract.

The third circumstance that will cause the termination of the agreement is the failure to comply with any of the conditions and terms of the agreement. A breach by one of the parties entitles the other to rescind the contract by its own unilateral action. However, in some jurisdictions, the judicial declaration of rescission is required.

<u>Effects of the termination of the contract</u>:

The effects of the termination of the contract vary according to its wording and type. When a facultative contract of reinsurance terminates, the reinsurer has no longer any liability under it. When a treaty is terminated, there are still individual cessions in force that will expire at different times (because some of the original contracts of insurance ceded under the treaty may be still in force and have different dates of expiry). Usually, the reinsurer will continue to be liable for the insurance policies which have not yet expired at the time of the cancellation of the treaty. In this case, the insurer will not be able to cede any more contracts under the reinsurance treaty. However, the insurance policies which were reinsured but have not yet expired or have not been renewed, will be covered by the reinsurance agreement until the date of expiry or renewal. The parties may also agree to cancel the unexpired cessions. In this last case, the reinsurer will return the unearned premiums. In the case of treaties arranged on a losses-occurring basis, the reinsurer has no liability for losses occurring after the termination of the treaty. Its liability will continue for those losses which occurred during the period of the agreement, but were not settled at the date of termination.

The following example clause considers both possibilities -the termination of the treaty and the unexpired insurance policies or only the termination of the treaty:

> In the event of this treaty being terminated, the reinsured shall have the option to cancel all reinsurances allotted hereunder and then in force and to debit the reinsurer with ____% (net of commission) of the premiums in the account for the last four quarters; otherwise, all reinsurances shall continue in force until the expiry of their current terms, unless previously cancelled by the reinsured.

D. The Arbitration Clause

Most reinsurance contracts contain arbitration clauses which enable the parties to settle certain disputes by means of arbitration. The scope of the submission to arbitrate depends on the wording of the contract. Some contracts provide that the parties shall submit to arbitration all disputes arising out of the contract. Other contracts limit the submission to disputes relating to the interpretation and validity of the contract.

The reinsurance industry has been able to operate almost free of judicial intervention by resorting to arbitration when there is some dispute. The avoidance of litigation has been possible mostly because of the concept of "honourable engagement" prevailing in the relations between insurers and reinsurers. This concept of "honourable engagement" is complemented by the principle of utmost good faith. [68] Because both the "honourable engagement concept" and the principle of utmost good faith have exercised a great influence in the reinsurance market, the industry has demanded an inexpensive, flexible, expeditious and friendly procedure conducted by experts on insurance (as opposed to court litigation) for solving the disputes that may arise between the parties. Arbitration meets these requirements and is widely used.

Since reinsurance relationships are usually long-term transactions, arbitration is an effective way of resolving disputes arising because of changes in the law which the parties did not or could not anticipate at the time the contract was executed.

In contrast, litigation is regarded unfavourably by reinsurers and insurers for the following reasons:

1) Litigation takes too much time and parties have the possibility of appealing.

2) Litigation is very expensive.

3) The strict application of legal and procedural rules might contradict or undermine the presumed intent of the parties to reach a fair result because it may be very difficult to prove certain facts according to the rules of evidence.

4) There is no possibility of preserving confidentiality when disputes are submitted to courts. Trials and applications before the court are matters of public record and all evidence given in court is given in public. Therefore, there is no possibility of hiding from the general public what the parties may wish to hide (profits, business practices, etc.).

5) There is the risk that a decision unfavourable or unfair to the reinsurance industry may become a legal precedent binding for the future.

Though the parties to reinsurance contracts try to settle the disputes in a friendly way by resorting to arbitration, this goal is not always possible to achieve. Arbitrations are still rare, but their number seems to be increasing. The probable reasons might be the

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[68] "The reinsurance relationship requires the exercise of fiduciary responsibility one to the other." Mr. Thomas Crittenden, "Is Arbitration a Viable Alternative to Litigation? What May or Must be Arbitrated? A Reinsurance Perspective" Forum, Winter 1977-1978, No. 13, p. 225.

following:[69]

1) A change of attitude toward the reinsurance relationship, resulting in a weakening of the concept of utmost good faith and fiduciary duty.

2) A greater emphasis on the contractual aspect of the reinsurance agreement than on the honourable concept. The legality and the strict rights and obligations have preeminence in the mind of the parties.

3) An increase in claims against reinsurers for the payment of an extracontractual insurance obligation. In this respect, both reinsurers and insurers have opposite points of view which have resulted in conflicts for the contractual relationships. An extra–contractual obligation is a payment the insurance company has to make by reason of some commission or omission which is independent of the insurance coverage. If the claim is independent of the original insurance, it also has to be independent of the reinsurance contract. Failure on the part of the insurance company to realize that an extra–contractual insurance payment is not covered by the reinsurance agreement creates a conflict that will be solved by arbitration.

4) The delay of the insurer in informing the reinsurer of an actual case that involves or might involve the reinsurance contract and in giving follow–up development information sufficient to allow the reinsurer to know of its actual or potential exposure. This delay prevents the reinsurer from participating in the handling of a case and from making recommendations for its solution.

Reinsurance arbitration

The clauses in the reinsurance contracts providing for arbitration vary from one contract to the other. However, the content is similar. An arbitration clause contained in a non–proportional treaty is taken as an example. Arbitration proceedings will be explained in Chapter VI of this thesis.[70]

> 1. All irreconciliable disputes or differences arising between the contracting parties hereto, with reference to any transaction under this agreement, shall be settled by arbitration.
>
> 2. Each party shall nominate an arbitrator and the two named shall select an umpire before entering upon the arbitration. The arbitrators and the

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[69] Ibid, p. 234.

[70] From the General and Mercantile Reinsurance Company of Canada Limited.

umpire shall be disinterested executive officers of insurance or reinsurance companies transacting business in Canada other than the parties signatories to this agreement.

3. In the event of one of the parties failing to name its arbitrator within thirty days of the the date upon which a demand for arbitration is made, or the two arbitrators failing to name an umpire within thirty days of their acceptance of appointment, the required arbitrator or umpire as the case may be, shall be selected by the General Manager of the Insurance Bureau of Canada. If an arbitrator or umpire, after being appointed, is unable or unwilling to act, a new arbitrator or a new umpire, as the case may be, shall be appointed to act in his place, in accordance with the procedure indicated in this article.

4. Each party shall submit its case in writing to the arbitrators within thirty days from the date of appointment of the umpire, but this period of time may be extended by majority consent, in writing, of the arbitrators and umpire.

5. The two arbitrators shall consider from the written cases submitted to them, what disputes or differences exist between the parties. Should they fail to agree, they shall inform the umpire of the points on which they have agreed and shall consider with him the points still unresolved and shall generally make available to the umpire all information in their possession relating to arbitration.

6. The arbitrators and umpire shall make their award and shall direct the bearing of costs with a view to effecting to general purpose of this agreement in a reasonable manner and may abstain from following the strict rule of the law, interpreting the present agreement as an honourable engagement, and not as a merely legal obligation.

7. The decision of the arbitrators, or, in the event of their not agreeing, the majority decision of the arbitrators and umpire, shall be final and binding upon both parties and shall be filed in writing with both parties. Arbitration shall take place in Toronto, Ontario, unless otherwise mutually agreed.

VI. Reinsurance in Canada and Guatemala

Reinsurance is mainly an international business because most countries do not have enough economic capacity to reinsure their own risks and must search for foreign reinsurers. The parties to a reinsurance contract often come from states with different legal systems and provisions regulating reinsurance. Canada and Guatemala were chosen as examples to make this comparison because they have different legal systems (mostly Common Law in Canada and civil law in Guatemala). This chapter will present the way in which reinsurance is regulated in both states.

A. Regulation in Canada

Reinsurance legislation is limited in Canada. Reinsurance companies operating in Canada may be registered under the Canadian and British Insurance Companies Act, the Foreign Insurance Companies Act, the law of Canada, the law of a province, or under none at all. The requirements for licensing a reinsurance company are the same as for an insurance company. The Insurance Act of Alberta is the source of the following comments.

The insurance companies operating in Alberta must obtain a license from the Superintendent (S. 25(1)). The insurer has complete freedom to reinsure the risks with any unlicensed reinsurer outside Alberta (S. 26). The insurer may also reinsure any risk of another insurance company carrying on the same line of business that it carries on itself (S. 12). Partial control of the reinsurance industry is achieved by the Superintendent by virtue of regulations concerning the assets that insurers must keep. If the insurer's reinsurer is not registered under the Alberta Insurance Act, but is incorporated under the laws of another province or under the Canadian and British Insurance Companies Act, the reduction authorized by Section 34(9) (in which the assets are reduced when the risk or part of it is reinsured) shall not be made unless the Superintendent is satisfied that (1) the financial condition of the reinsurer is satisfactory, and (2) the operations of the reinsurer are conducted in accordance with sound business and financial practice(S. 34(11)). If the

reinsurer is not registered under either Act and is not incorporated under the laws of Canada or any province, the assets that the insurer must keep will be reduced in respect of a policy, group of policies or a claim in or outside Canada reinsured with that reinsurer, only to the extent that security is maintained in or outside Canada, respectively. The security of the potential obligations of the reinsurer has to be made in an amount, of a nature and under arrangements satisfactory to the Superintendent (S. 34(12)). Apart from these limitations on the ceding company, there are no requirements as to registration of the contracts and the reinsurers are free in everything related to policies, premiums and conditions.

Section 538 of the Act refers to reinsurance as an agreement by which contracts made in Alberta by a licensed insurer or any class or group thereof are undertaken or reinsured by another insurer, either by novation, transfer or assignment. Section 539 stipulates that nothing in part 17 affects the contracts of reinsurance of individual risks made by insurer in the ordinary course of business, or contracts made with unlicensed reinsurers. Therefore, the term "reinsurance" as used in this part has a different meaning.

It is important to note that besides limited regulation in the area of reinsurance, the number of cases dealing with this subject is also very limited. Since most contracts contain arbitration clauses to solve the disputes that may arise out of the contract, most of the cases are dealt with privately.

The National Reinsurance Company of Canada

The National Reinsurance Company of Canada was incorporated in 1948. It is federally registered and its capital comes mostly from Canadian sources. It was acquired from French interests in 1965 and has moved from primary insurance into the major Canadian reinsurance market. The two goals of the company are: (1) to provide Canadian insurance companies with truly Canadian reinsurance capacity, and (2) to create a Canadian capacity to reinsure international risks. The purpose is to modify the Canadian pattern of merely ceding reinsurance business to international reinsurers. A marketing office was opened in Paris in 1978 and there are plans to open new offices in the United States and London. One of the major functions of the company is to serve as a conduit for foreign unlicensed reinsurers, willing to participate in Canadian business but unwilling to be

licensed. Acting as a broker has given the National Reinsurance Company many useful contacts abroad. In addition, unlicensed reinsurers have become licensed and have helped National Reinsurance to acquire foreign business and to exchange retrocessions. The company has started to retrocede a share of its foreign risks to Canadian primary insurance companies in order to fulfill its second goal of providing Canadian capacity for international risks.

B. Regulation in Guatemala

Only four articles of the Code of Commerce regulate the reinsurance contract.[71]

Article 1020 states that by the reinsurance contract, the insurer transfers to the other insurer or reinsurer, the whole or part of its own risks.

Article 1021 states that in case the parties do not address their minds to a specific point, the rules of reinsurance internationally accepted will apply in the first place, and may be supplemented by the applicable rules of the Code of Commerce.

Article 1022 states that the disputes between reinsurer and reinsured will be settled pursuant to any arbitration clause in the contract. That clause must express that the arbitrators shall be experts and shall consider mainly the usages and practices of reinsurance internationally accepted.

Article 1023 states that the direct insured or his beneficiary has no action against the reinsurer.

The regulations are minimal and the parties have freedom to agree on the terms they wish. The principles of contracts contained in the Code of Commerce and Civil Code will apply to the contract.[72] The only special requirement for the insurance and reinsurance companies is that they must be licensed.[73] If the reinsurance company is foreign, the insurance company in Guatemala must present to the Department of Insurance a certificate stating that the reinsurer is legally constituted in its country of origin.

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[71]The text of the statute has not been included here because it is in Spanish. The translation was made by the writer of the thesis.
[72]The regulations concerning contracts contained in the Civil Code are applied to the commercial contracts by virtue of article 1517 of the Code of Commerce.
[73]Articles 875 and 877 of the Code of Commerce and article 473 of the Decree-Law No. 473.

Registration of reinsurance contracts

Article 1022 of the Code of Commerce also stipulates that reinsurance contracts must be registered at the Department of Insurance and Bonds, which is a division of the Superintendence of Banks. The Superintendence of Banks is the governmental authority in charge of the supervision of the insurance companies. In order to register a reinsurance contract, the insurance company applies for an inscription. The application must be presented with the original contract and a copy; a written evidence extended by a competent authority of the country where the reinsurance company was incorporated, certifying that the company operates according to the laws of that country; and the financial statement of the reinsurer. These last two documents must be legalized by the Ministry of External Relations of Guatemala and translated into Spanish.[74] If the insurance company makes various contracts of reinsurance with the same reinsurer, it need only provide the reinsurance contract and a copy for each subsequent transaction.

After the documents are received, an inspector is appointed to make a technical examination of the contract and write a report. If the inspector makes no objection, the contract is registered by an order issued by the Department. If the inspector objects to one of more clauses of the contract, the insurance company is given a hearing by the Department of Insurance and Bonds according to its own internal procedure.

After the registration is completed, the Department keeps a file in which all the modifications and cancellations of the contract will be registered.

Effects of the registration

According to the statutes, the function of the Superintendence is only the function of registering the contracts. Theoretically, it has no power to object to a provision in the contract, nor to ask for a modification prior to its registration. However, in practice, the Superintendence does on occasion object to the content of some contracts. This may be due possibly to the lack of understanding of the distinction between insurance and reinsurance contracts. The Superintendence considers reinsurance contracts as insurance contracts and attempts to exercise the same control it is empowered to exercise over the

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[74] Article 190 of the Law of the Judiciary.

activities of the insurance companies. This interference of the Superintendence is questionable because of its lack of legal basis and may create problems for the parties. The contract is already made when it is presented to the Superintendence and the parties may not agree to modify it in order to satisfy the authority. The practical consequence is that the contract, although not registered, will have full force. According to the wording of the statute, the registration of a reinsurance contract only has statistical and declaratory effects and lack of registration does not interfere with the validity of the contract.

C. International Practice of Reinsurance

The spreading of risks of domestic insurers among reinsurers is to the advantage of the domestic insurance industries because:

1) Large risks may cause losses which may account for a substantial proportion of the total premium income of the domestic insurers.[75]

2) Catastrophe risks, mainly where a country is exposed to natural perils, may destroy a significant part of its productive resources.

3) International reinsurers may be able to offer lower premiums or a better service.

4) The major reinsurance companies and brokers offer considerable technical and training assistance for ceding companies.

Despite the great advantages of placing reinsurance with foreign reinsurers, restrictions are being established on international reinsurance transactions, particularly by the governments of developing countries.

What are the reasons for those restrictions? The restrictions are usually placed by the governments and supervisory authorities. in order to:

1) Protect local policyholders from the consequences of the insolvency of foreign reinsurers that are not under the control of the local authorities.

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[75]A study of the UNCTAD reported that "One developing country has seven insurance policies covering its mining industry which account for 70% of its total premium income produced by all classes of insurance operated in that country.' (Insurance of Large Risks in Developing Countries, TD/B/C, July, 1977).

2) Build up a local insurance and reinsurance market, possibly as part of the planned growth and diversification of the economy.

3) Protect the balance of payments and foreign exchange reserves from outflows of premiums and capital funds.

4) Retain funds generated by insurance operations for local investment.

5) Protect the domestic market which has no economic need for additional capacity or rate competition.

6) Prevent the dominance of the domestic market by economically powerful foreign interests.

Restrictions

Reinsurance is one of the freest types of international insurance transactions. Controls are directed generally toward the taxation, reserves, and exchange rather than to the regulation of the rights and liabilities of the parties under the contract.

The restrictions on foreign reinsurers may be direct or indirect.

Direct restrictions:

Direct restrictions exclude foreign reinsurers from establishing in a country or restrict their participation to a share in locally incorporated companies and prohibit local insurers from placing reinsurance abroad.

Foreign companies have been ejected from many countries as a consequence of policies of general nationalization or domestication. When foreign reinsurers have been permitted to retain a share in locally incorporated companies, they have been restricted to a minority interest, with national interests holding the majority of the shares and exercising management control.

Indirect restrictions:

Indirect restrictions make reinsurance transactions less profitable to or more difficult for either the reinsurer or the ceding company. The following measures are the most common:

1) Localization of reserves: Sometimes reinsurers are compelled to maintain sufficient funds within the countries in which they operate to cover their liabilities to ceding companies. The regulations may also specify the types of securities (usually government securities) in which the funds shall be held. The pressure to deposit funds locally may be exercised indirectly through the solvency regulations applying to ceding companies. For example, the authorities may deny the deduction from premium and loss reserves if the reinsurance contract is made with a foreign reinsurer.

The result in both cases is that the reinsurers' reserve funds are fragmented. In order to provide the same global standard of security to all ceding companies, the reinsurers will have to maintain larger capital funds than otherwise would be needed. Therefore, the cost of reinsurance and direct insurance will increase.

2) Local incorporation: If foreign reinsurers are permitted to operate only through local incorporation, the capital cost may be increased because a relatively larger capital may be required for a local company than for a larger group. Again, the insurance and reinsurance premiums will increase.

3) Taxation: Some tax measures may prevent ceding companies from doing business with foreign reinsurers. In some countries, special taxes are levied on foreign reinsurers. Subsidiary companies of foreign reinsurers may subject to effectively higher rates of corporate tax than domestic companies.

4) Exchange control regulations: Most countries impose exchange control on the remittance of funds abroad. Some countries have imposed exchange control regulations which, by officially delaying the remittance abroad of reinsurance premiums, operate like deposit regulations. These regulations can seriously impede the settlement of accounts for foreign reinsurances to the detriment of both ceding and reinsurance companies.

Effects of the restrictions:

If domestic insurance companies are prevented from ceding business to foreign reinsurers, the economy will lack the inflow of foreign currency needed to repair the damage or restore the economy after a catastrophe occurs. When reinsurers are obliged to maintain assets locally, they will invest directly or indirectly in the physical assets which they are reinsuring. Generally, this situation should not affect the solvency of the reinsurer, provided the investment of the funds can be spread so widely that no one physical asset accounts for more than a very small part of the total investment. However, funds held for catastrophe risks, such as earthquake, windstorm, and flood must receive a different treatment. The only way in which a reinsurer is able to pay claims arising from a widespread natural disaster is to invest the funds in assets which will be unaffected by the occurrence of the event. The costs of reinsurance are also increased as a consequence of the fragmentation of the reinsurers' reserves.

The indirect effects of the restrictions placed on foreign reinsurers must also be considered. If restricted access to international reinsurance markets results in a lack of adequate reinsurance cover, especially for new technology, businessmen will be less willing to take risks, thus reducing the efficient use of the resources. Also, if foreign reinsurers are prevented from establishing business in a country, it may be deprived of badly needed external capital and technology. Finally, the interest of the insurance consumers must taken into consideration. If the needs of traders and corporate buyers cannot be met by the domestic market because of the impossibility of contracting with foreign reinsurers, the domestic economy will be mostly affected.

Restrictions in different countries:

In the United States, reinsurance transactions result from open competition in both rates and other terms of contract. The control of the reinsurance companies is directed not at the reinsurance transaction but to the ceding insurer. The authorities may accept or deny reinsurance as an admitted asset or reduction from liability on the financial statement of the company, depending upon whether or not the reinsurer

is licenced and admitted or approved in the state. Some discrimination may exist in the licensing of a foreign reinsurer, by the requirement of higher paid-in capital. Depending on the state, approval rather than licensing may be accomplished by the acceptance on the National Association of Insurance Commissioners list of approved nonadmitted reinsurers, proof of a licence in at least one state, a trust fund established for the benefit of the U.S. policyholders, a letter of credit protecting reinsurance liabilities, or alternatively, actual retention by the ceding company of unearned premium and loss reserves.[76]

In the European Economic Community, the restrictions on the right of companies from other member countries to establish reinsurance operations and provide reinsurance and retrocessional services were abolished by a directive issued by the European Economic Council in 1964.[77] However, foreign reinsurers face restrictive law and practices designed to preserve the market for domestic reinsurers. France, for example, does not allow deduction in assets for reinsurance contracts made with foreign companies and the foreign reinsurers must get state admission. Austria, Switzerland and Germany allow deductions in assets for business ceded to foreign reinsurers, but insurance companies are subject to governmental control of their investments.

In South America, Africa and Asia, national reinsurance companies receive compulsory cessions. This trend is encouraged by the United Nations Conference on Trade and Development for Developing Countries (UNCTAD).[78] In some cases, the national reinsurer has the right of first refusal on external cessions (Brazil, Chile and Peru) or may demand a proof of lack of capacity in the domestic market. In Mexico, a certain proportion of all reinsurances must be placed locally before any business can be reinsured abroad.

In Australia and New Zealand, the deduction of reinsurance premiums is disallowed unless they are included in a return by the reinsurer and taxed accordingly.

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[76]New York Regulation 20 is an example of the alternative regulatory requirements for approval as an unlicensed reinsurer).

[77]Council Directive 641225 of February 25, 1964.

[78]United Nations Document Executive Conference 46/141, vol. 1, 1964. This is the case of Kenya, Nigeria, Argentina, Brazil and Chile.

What is the actual trend? Although over the last thirty years the world political climate has become less favourable toward international reinsurance, there seems to be a slight change of attitude directed to the liberalization of the restrictions. The discussions within the Organization for Economic Cooperation and Development (OECD) have not produced any real progress toward the liberalization of the restrictions on the reinsurance industry, but some progress has been made elsewhere. For example, as the first step for the creation of the common market of insurance, the European Economic Community issued its 'Directive for the Abolition of Restrictions on Freedom of Establishment and on the Free Supply of Services of Reinsurance and Retrocession' in 1964. South Korea is both denationalizing its state reinsurance corporation and relaxing its restriction on foreign insurers.

D. Conclusion

Both the statutes of Canada and Guatemala are similar in that they permit the free operation of foreign unlicensed reinsurance companies. One would expect significant differences in Canada's statutes because of its developed economy. However, such is not the case. Unlicensed reinsurance companies are not required to keep assets in Canada to guarantee their obligations. The only way in which the Superintendent can control indirectly the cessions made to unlicensed reinsurers is by refusing to allow deductions in the insurers' reserves for those cessions. There is no similar control in Guatemala, where the Superintendent need only be given a copy of the contract and whose power does not extend to render the contract invalid even if it is not registered.

If one compares the way in which reinsurance has worked in Canada and Guatemala, it can be said that it has operated effectively in both countries. The lack of regulation has not caused undesirable effects on the behavior of the industry. The good faith prevailing in the relations betwen reinsurers and insurers has taken the place of the absent regulations. Another factor that eases the contractual relation is that both parties are experts on the subject of reinsurance. Expertise plus utmost good faith have been the main ingredients of the smooth relation between the parties.

The main function of reinsurance is to spread the risks, since in many instances, the spreading of risks domestically is insufficient to provide the security policyholders and national economies require. In order to fulfill this function, reinsurance companies must operate worldwide. If governments place direct or indirect restrictions in the placement of reinsurance abroad, they will be preventing the development of the national economy and industry and will be creating serious defficiencies in the supply of primary insurance. There are sound reasons for believing that the indirect economic costs of the restrictions on international reinsurance transactions may outweigh the apparent benefits.

What is greatly needed is the cooperation and trust between the supervisory authorities of the different countries. Domestic authorities must be prepared to delegate responsibility for the supervision of foreign reinsurers to the authorities of their countries of domicile. This would be a more efficient solution, than for each country to seek to impose its own controls. Developed countries must lead the way toward greater freedom for international reinsurance.

VII. Conflicts of Laws in Reinsurance

The contract of reinsurance is often an international contract because the parties are nationals from different countries. It is very important, therefore, to study the conflicts of laws in the main areas which are: 1) the proper law of the contract, in order to have an standpoint to analyze the formation, validity, interpretation, performance and termination of the contract; 2) the arbitration proceedings, because arbitration is the usual way to resolve disputes arising out of the contractual relation; and 3) the enforcement of foreign arbitral awards, because the problem of enforcing foreign arbitral awards is even greater when there is no treaty between the states, as in the case of Canada and Guatemala.[79]

A. Canada

The proper law of the contract

If one is to understand the concept of the proper law of the contract, the first thing that one has to consider is the freedom of the parties to choose a system of law to govern the contract.

In Canada, the parties are free to select any system of law to govern their contract even if it is totally unconnected with the transaction. The choice is limited only in that it must be *bona fide* and legal and there must be no reason for avoiding the choice on the ground of public policy. This means that the parties cannot avoid the mandatory provisions of the system of law with which the transaction has its most real and substantial connection.[80] The authority for this proposition is the case of *Vita Food Products Inc. v. Unus Shipping Co. Ltd.*[81] However, this decision has been critized by Morris and Cheshire

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[79]Neither Canada nor Guatemala are parties to the New York Convention of 1958 for the Recognition and Enforcement of Foreign Arbitral Awards and the Geneva Convention of 1961.
[80]J.-G. Castel, Introduction to Conflict of Laws, p. 165.
[81](1939), 2 D.L.R. 1, (1939), 1 W.W.R. 433, (1939), A.C. 277 (P.C.).

because:

> To attribute so much weight to the intention of the parties is unsound in principle and unworkable in practice, since it would allow the parties to evade some inconvenient rule of the law with which the contract has the closest factual connection... The qualifications imposed upon the parties' freedom of choice are vague and indeterminate, and beg the question.

Lord Diplock defined the term "proper law of the contract" in the case of *Compagnie d'Armement Maritime S. A. v. Compagnie Tunisienne de Navigation, S.A.*:[82]

> When parties enter into an agreement which they intend to give rise to legally enforceable rights and liabilities, they must ex necessitate contemplate that there will be some system of law by referrence to which their mutual rights and liabilities will be determined, i.e., the substantive or "proper law of their agreement...

The proper law in this context is the system of law which governs the interpretation, the validity of the contract and the mode of performance and the consequences of breaches of the contract.

Lord Simonds, in the case of *Bonython v. Commonwealth of Australia*,[83] stated that the proper law of the contract is the system of law by reference to which the contract was made or that with which the transaction has its closest and most real connection. In making his statement, Lord Simonds was considering two situations. The first situation is the one in which the parties to a contract make reference to a particular system of law. This situation is subject to two different interpretations. Under the first interpretation, two possibilities exist: the first possibility is that the parties themselves choose a system of law and this selection is a term of the contract; the second possibility is that the parties do not make an express choice but it can be inferred from the terms of the contract. In this last case, the court will examine the entire contract in the light of relevant circumstances and will apply the ordinary rules of construction of commercial contracts in order to ascertain whether the parties have agreed in selecting the proper law.[84] In making the examination of the contract, the court will consider competing factors in the light of commercial intention and will apply sound ideas of business, convenience and sense to the language of the contract.[85]

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[82](1971), A.C. 572, at 603 (H.L.).
[83](1951), A.C. 201 (P.C.).
[84]*Compagnie d'Armement Maritime S.A. v. Compagnie Tunisienne de Navigation, S.A.* (1971), A.C. 572 (H.L.).
[85]Ibid., at 600, per Lord Wilbeforce.

Under the second interpretation, expressed by professor Castel, the only way to refer to a system of law is by making an express choice of law. If there is no express choice of law, the law of the contract is the law with which the transaction has its closest and most real connection. The decisions which make reference to the intention are uncertain, since

> ...it is not ascertained whether the expression means the system of law by which the parties intended the contract to be governed had they directed their minds to this matter, or the system of law which reasonable men in the position of the contracting parties would presumably have intended. In other words, should the doctrine of the proper law be formulated subjectively or objectively.[86]

Furthermore, it does not matter which formula is applied, since the outcome will be the same: where there is no express choice of law by the parties, the court will apply the law of the country with which the transaction is most closely connected. Professor Castel concludes that the House of Lords rejected the legal fiction of the presumed intention and adopted the view that in the absence of express choice, the proper law means the system of law with which the transaction has its closest and most real connection.[87]

The second situation contemplated by Lord Simonds is the one in which the parties have not selected the proper law. In this case, the system of law with which the transaction has its closest and most real connection is applied. This connection is the one between the transaction –the substance of the contract– and a system of law.[88] In order to find the connection, the courts will take into consideration many factors: the choice of jurisdiction in arbitration clauses;[89] the forms of documents involved in the contract; the terminology of the contract, which may only be appropriate to a particular system of law; the usage of a particular language; the residence and nationality of the parties; the nature and location of the subject matter of the contract; the currency in which payment is to be made; a connection with a preceding transaction; the fact that one of the parties is a

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[86] J. G. Castel, Introduction to Conflict of Laws (Toronto: Butterworths, 1980), p. 159.
[87] *James Miller and Partners Ltd. v. Whitworth Street States (Manchester) Ltd.*, A.C. 583, (1970); 1 All E.R. 769, (H.L.).
[88] *Coast Lines v. Hudig & Veder Chartering N.V.* (1972), 2 Q.B. 34 at 46, per Megaw L.J.,(C.A.).
[89] *Hamlyn & Co. v. Talisker Distillery* (1894), A.C. 202 (H.L.(SC.)); *N.V. Kwik Hoo Tong Handel Maatschappij v. James Finlay & Co. Ltd.* (1927), A.C. 604; *Re O'Brien and Canadian Pacific Ry. Co.* (1972) 25 D.L.R.(3d.) 230 (Sask.) However, in two recent cases the House of Lords held that the proper law of the contract was a law other than the law of the place of arbitration and this latter only governed the arbitration procedure. See *James Miller and Partners Ltd. v. Whitworth Street Estates (Manchester) Ltd.* (1970), A.C. 583; *Compagnie Tunisienne de Navigation S.A. v. Compagnie d'Armement Maritime S.A.* (1971), A.C. 572 (1970).

government; and the fact that the contract is valid under one law but invalid under another.[90]

Strangely enough, each of the different interpretations of the statement of Lord Simonds in *Bonythom v. Commonwealth of Australia*[91] has been followed in Canada. The first interpretation (which refers to the express choice of law and the inferred intention from the terms of the contract) was adopted in the case of *Re O'Brien and Canadian Pacific Railway*,[92] in which Cullington C.J. made the following statement:

> The general principles to be followed in determining the law governing a contract, or a particular issue within the contract such as arbitration proceedings, may be stated as follows:
> (1) If the intention of the parties as to the law governing is expressly stated in the contract, then in general that law governs;
> (2) If the intention of the parties as to the law governing the contract, or a particular matter therein, is not expressly stated but may be properly inferred from the terms and nature of the contract and the surrounding circumstances, then the intention so inferred, in general, governs;
> (3) If the intention of the parties as to the applicable law cannot be ascertained from the express terms of the contract, or cannot be inferred from the terms of the contract in the light of surrounding circumstances, the intention of the parties may be inferred by refering to the system of law with which the contract has its closest and most real connection.

The second interpretation expressed by professor Castel was adopted in *Imperial Life Assurance Co. of Canada v. Colmenares*[93] in 1967 by the Supreme Court of Canada. In this case, Ritchie J. said:

> It appears to have been accepted by the highest courts in England that the problem of determining the proper law of the contract is to be solved by considering the contract as a whole in light of all the circumstances which surround it and applying the law with which it appears to have the closest and most substantial connection.

He then expresed that this test was adopted by the Privy Council in *Bonython v. Commonwealth of Australia*[94] (where Lord Simonds said at p. 219 that the proper law of the contract is the system of law by reference to which the contract was made or that with which the transaction has its closest and most real connection) and by the House of Lords in *Tomkison et al. v. First Pennsylvania Banking and Trust Co.*[95] Since the decisions of the Supreme Court prevail, it seems that in Canada, in the absence of an express choice of law by the parties, the proper law of the contract is the law with which

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[90] Cheshire's International Private Law, Norton, ed. 10th ed.(1980), pp. 205–6.
[91] (1951), A. C. 201 (P.C.).
[92] (1972), 25 D.L.R. (3d) 230, at 233–4 (Sask.C.A.).
[93] S.C.R. 443, 62 D.L.R. (2d), 138, 1.L.R. 1–183.
[94] (1951), A.C. 201.
[95] (1961), A.C. 1007, per Lord Denning at p. 1068.

the contract has its closest and most real connection.

Which is the proper law and what constitutes the connection in order to localize a reinsurance contract? There is no specific case dealing with this point. However, the decision of the Supreme Court of Canada in *Imperial Life Assurance Co. of Canada v. Colmenares* provides guidelines to determine the proper law of the reinsurance contract, when the reinsurer is a Canadian company. In this case, a Cuban national, while resident in Cuba, applied to the Cuban branch office of a life insurance company for two life insurance policies. The company had its head office in Toronto. The applications and the policies were in Spanish and many premiums were paid in Cuba in pesos. The policies were to be in force when they were delivered and accepted in Cuba and were authenticated by a Cuban notary. The decision to accept the risk was made, and the policies and the premium receipts were prepared in Toronto. All the claims had to be forwarded and dealt with in Toronto as well as the variations of the policies and their assignments. Each policy contained a provision stating that all payments whether to or by the company were required to be made by bank draft drawn on New York payable in the legal currency of the United States of America. The insured moved to the United States and applied for the cash surrender value in American dollars as permitted by the policy. At the same time, there was a Cuban foreign exchange law that forbid the payment of obligations otherwise than by Cuban pesos in Cuba. Colmenares' claim was valid if the proper law of the contract was the Ontario law. The policies contained no express choice of law.

Ritchie J. concluded that the law of the contract was the Ontario law. The facts that constituted the connection with the Ontario law were the following: the risk was accepted in the company's head office in Toronto and the contract was made when the company mailed the policies in Toronto; both applications and policies were prepared in Toronto in a standard form which complied with the law of the province; any changes or alterations in the contract were to be made in Toronto; the receipts for premiums were valid only if signed by one of the executive officers in Toronto. The fact of preponderant importance in determining the law of the contract was the preparation of the application and policies in Toronto, in a standard form which complied with the law of the province.

Which is the proper law of the reinsurance contract then, where the reinsurer is a Canadian company? Following the guidelines of the *Colmenares* decision and in the absence of an express choice of law by the parties, it is probable that the contract would be considered as subject to Canadian law, although the facts of a contract of life insurance are not the same as those of a reinsurance contract. The facts that would localize the contract in Canada would be: (1) The policies would be prepared in Canada; (2) The risk would be accepted in Canada. Even if according to Guatemalan law, the contract is subject to that law, there is some authority that a court would not be debarred from determining on its own principles that the proper law of the contract is A by the fact that the courts of B have held or would hold that the proper law of the contract was the law of B or some law other than A.[96] Another important factor to localize the contract would be the place of performance. According to the statement of Diplock in the case of *Pick v. Manufacturers' Life Insurance Co.*, the place of performance would be Guatemala.[97] Nevertheless, the two factors mentioned before would localize the contract in Canada, because the place of performance is not conclusive in localizing the the contract. Since reinsurance companies may be licensed or not, the fact that the policies comply with a provincial law would not be an important factor. Ritchie J. stated that the location of the head office of an insurance company whose activities range over many countries does not afford justification for the general proposition that the proper law of the contract of life insurance in necessarily the country in which the head office of the insurer is situated.[98] Despite this reservation expressed by Ritchie J., the domicile of the reinsurer would be useful in localizing the contract.

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[96] *Rossano v. Manufacturer's Life Insurance Co.* (1963), 2 Q.B. 352.

[97] Situs of debt: Diplock expressed the view that the primary place for the delivery of the bankers' draft on London was the head office in Toronto, but that until the draft was honoured in London, the delivery of the draft was conditional payment only, and the primary place of payment was London. (1958), 2 Lloyd's Rep. 93.

[98] The principle that the law of the country where the head office of an insurance company is situated is the proper law of the contract was followed in *Pick v. Manufacturers' Life Ins. Co.* (1958), 2 Lloyd's Rep. 93 and in *Rossano v. Manufacturers Life Ins. Co.* (1963), 2 Q.B. 352.

B. Guatemala

The law of the contract

The conflicts of laws rules applicable to international contracts are contained in the Law of the Judiciary. Article 18 of this statute establishes the rule that the law of the place where the contract has to be complied with governs everything related to its nature, validity, effects, consequences, execution and any other aspect of the contract. However, the external formalities of the contract are subject to the law of the place where the contract was made (article 19). Therefore, unlike Canada, the parties do not have the freedom to select a law other than the law of the place of performance.

Assuming that a Canadian company is the reinsurer and a Guatemalan company is the reinsured, the performance of the contract takes place in Guatemala. The reinsured in Guatemala will pay the premiums and send them to the reinsurer in Canada, and in return, the reinsurer in Canada will pay for the loss of the reinsured and will send the money to Guatemala. Since the performance of the contract is made in Guatemala where the insurer receives the payment from the reinsurer (and possibly taking into consideration that the subject matter of the contract is the reinsured's liability for risks situated in Guatemala), it would be determined that the contract is subject to Guatemalan law.

Conclusion

The determination of the proper law of a reinsurance contract depends on the law of the place where the action or the arbitral proceedings are commenced. Assuming that a Canadian company is the reinsurer and a Guatemalan company is the reinsured, the Guatemalan law will apply to the contract if the action or the arbitral proceedings are commenced in Guatemala. Even if the parties select another law expressly, the Guatemalan law must be applied because of the imperative provision of article 18 of the Law of the Judiciary. If the action or the arbitral proceedings are commenced in Canada, it will probably be determined that the proper law of the contract is the Canadian law, in the absence of an express choice of law by the parties. This conclusion was derived from the

case of *Imperial Life Assurance Co. of Canada v. Colmenares,*[99] by analogy, in the absence of a specific case on the matter.

The arbitrators are usually the ones who have to determine the law of the contract because most reinsurance contracts contain arbitration clauses. The first thing the arbitrators would do is to find out if they have jurisdiction according to the submission to arbitrate.[100] Second, they will determine the law of the contract according to the conflict rules of the place where the arbitration proceedings are being conducted.

C. Arbitration in Canada

The ten provinces have enacted legislation dealing with arbitration. The Common Law, federal statutes and territorial ordinances are applied in federal territories. In order to give a general view of the arbitration procedure, reference to the arbitration legislation of Quebec and Ontario will be made. Quebec was chosen because it is the only civil law province of Canada and Ontario because its legislation is similar to the acts of the other Common Law provinces. It is understood that each province may have different provisions from those of the Ontario Arbitration Act in some sections.

Undertaking and submission: The law of Quebec, like the law of Guatemala, makes a distinction between an undertaking to arbitrate future disputes (clause compromissoire)[101] and a submission to be executed by the parties when the dispute has already arisen.[102]

The Ontario Act makes no distinction between these two situations.[103]

Enforcement of undertaking and submission: The statutes of both provinces provide for means of enforcing the undertakings and submissions by granting the stays of

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[99](1967) S.C.R. 443, 62 D.L.R. (2d), 138, 1 L.R. 1-183.
[100]In Canada, there are two views for the determination of the effect of a jurisdiction clause. One is that the effect of the jurisdiction clause has to be determined by applying the lex fori (the law of the court). *Neptune Bulk Terminals Ltd. v. Intertec Internationale Technische Assistenz* (1981), 127 D.L.R. (3d) 736.(B.C.C.A.). The other view is that the effect of a jurisdiction clause is determined by the proper law of the contract. *Carveth v. Railway Asbestos Packing Co.* (1913), 9 D.L.R. 631.(Ont. S.C.) in which the Ontario court applied Quebec law as the proper law of the contract in determining whether the jurisdiction clause was exclusive in nature. According to this position, the interpretation of a contract (including of the jurisdiction clause) is governed by its proper law. However, this last position does not determine the law according to which the proper law of the contract has to be found.
[101]Articles 940, 941, 944 and 945 of the Code of Civil Procedure.
[102]Ibid., article 951.
[103]Section 1(d) of the Arbitration Act.

proceedings.[104]

> The authorities are to the effect that when once it appears that the agreement for arbitration covers the claim stated in the action, it is the prima facie duty of the court to allow the forum, which the parties have agreed to, to settle the matter in dispute, and the onus of showing that the case is not a fit one for arbitration is upon the person who opposes the stay of proceedings.[105]

Arbitration clauses usually take two forms. One clause merely provides for arbitration and the other one makes arbitration a condition precedent to any litigation –*Scott v. Avery* clause.[106] To enforce an ordinary arbitration clause, the interested party applies under the Arbitration Act to stay whatever proceedings are in progress.[107] To enforce a *Scott v. Avery* type of clause, it is just necessary to raise the argument of condition precedent. Therefore, it was held that the courts have no jurisdiction to hear a cause of action until the arbitration process is completed.[108]

The granting of a stay of proceedings is a discretionary power.[109] The application to stay proceedings has to be made before delivering any pleading or taking any other step

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[104]Quebec: Article 951 of the Code of Civil Procedure. Ontario: Section 7 of the Arbitration Act.

[105]*Altwasser v. Home Insurance Company of New York* (1933), 2 W.W.R., 46 at 50 (Sask. C.A.).

[106](1856) 10 E.R. 1121 (H.L.).

[107]*Grannan Plumbing and Heating Ltd. v. Simpson Const. Ltd.* (1977), 17 N.B.R. (2d) 569 at 574 et seq. Reversed on another point 24 N.B.R. (2d) 238 (C.A.).

[108]*Nolan v. Ocean, Accident etc. Corp. Ltd.* (1903), 5 O.L.R. 544 (C.A.).

[109]Section 7 of the Ontario Arbitration Act. Brandon J, in the case of *The Eleftheria* (1970) P.94 at pp.99–100, stated the facts to take into consideration when the court exercises its discretion:

> The principles established by the authorities can, I think, be summarized as follows: (1)where plaintiffs sue in England in breach of an agreement to refer disputes to a foreign court, and the defendants apply for a stay, the English court, assuming the claim to be otherwise within its jurisdiction, is not bound to grant a stay but has a discretion whether to do so or not. (2) The discretion should be exercised by granting a stay unless strong cause for not doing so is shown. (3)The burden of proving such strong cause is on the plaintiffs. (4)In exercising its discretion the court should take into account all the circumstances of the particular case. (5)In particular, but without prejudice to (4), the following matters when they arise, may properly be regarded: (a) in what country, the evidence of the issues of fact is situated, or more readily available and the effect of that on the relative convenience and expense of trial as between the English and foreign courts. (b)Whether the law of the foreign court applies and, if so, whether it differs from English law in any material respects. (c)With what country either party is connected, and how closely. (d)Whether the defendants genuinely desire trial in the foreign country or are only seeking procedural advantages. (e)Whether the plaintiffs would be prejudiced by having to sue in the foreign court because they would: (i)be deprived of security for their claim; (ii)be unable to enforce any judgment obtained; (iii)be faced with a time-bar not applicable in England; or (iV) for political, racial, religious or other reasons be unlikely to get a fair trial.

in the proceedings.[110]

Form: Article 951 of the Code of Civil Procedure of Quebec states that an undertaking to arbitrate must be in writing. However, if both parties confirm the existence of an oral undertaking, it will be valid.[111] Under Common Law, the submission need not be in any special form.[112] However, in the opinion of professor McLaren, an agreement for arbitration must comply with formal requirements of execution under seal and delivery in order to demonstrate the agreement.[113]

Number of arbitrators: In Quebec, the number of arbitrators must be one or three.[114] In Ontario, there is no limitation as to the number. If the parties make no reference to the number of arbitrators, it is deemed that they have chosen one arbitrator.[115]

Revocation of appointment: In Quebec, the arbitrators can be dismissed with the unanimous consent of the parties.[116] In Ontario, an appointing party may not revoke the authority of the arbitrator to act after the appointment is made, unless the submission to arbitration was oral,[117] or by leave of the court.[118]

Amiables compositeurs: In Quebec, the parties may empower the arbitrators to act as mediators, who are not bound by rules or law. However, their decision must contain the reasons for it.[119] In Ontario, there is no specific provision as to amiables compositeurs. Nevertheless, there are opinions that amicable composition should be allowed in Common Law jurisdictions.[120]

Rules of law: In Quebec, the arbitrators must decide according to rules of law, unless they have been exempted from doing so or have been empowered to act as amiables compositeurs.[121] In English law arbitrators have to decide strictly according to

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[110] Ibid.
[111] *Pollack v. Verret* (1931) 51 B.R. 109, 115.
[112] *McIsaac v. Iverness Ry & Coal Co.*, (1905), 38 N.S.R. 80; reversed on other grounds 37 S.C.R. 134.
[113] Richard McLaren, The Law and Practice of Commercial Arbitration (Toronto: The Carswell Company Limited, 1982), p. 17.
[114] Article 941 of the Code of Civil Procedure.
[115] Section 1, Schedule A of the Arbitrations Act.
[116] Article 942 of the Code of Civil Procedure.
[117] *Hill v. Simmonds* (1913), 14 D.L.R. 877 at 881 (C.A.).
[118] Section 4 of the Arbitrations Act.
[119] Article 948 of the Code of Civil Procedure.
[120] Clive M. Schmitthoff, "Arbitration: The Supervisory Jurisdiction of the Courts," The Journal of Business Law 1967, p. 328.
[121] Article 948 of the Code of Civil Procedure.

law. The parties cannot empower the arbitrators to decide according to an equitable rather than a strictly legal interpretation because the adoption of that extralegal criterion would make it impossible for the court to exercise its supervisory jurisdiction on the statement of a special case. The court would not be able to determine whether the arbitrator had fallen into an error when deciding a question of law because he was not bound to apply the law but could decide the case according to his own concept of commercial fairness and justice.[122] Since Canada follows the rule of the stated case, this principle would also apply to Canadian arbitration proceedings, with the exception of Quebec (where the statutes provide for amiables compositeurs).

> It is thought that that rule unduly restricts the development of English arbitration. There is no reason why the parties, if they desire, should not give the arbitrators the jurisdiction of amiables compositeurs. The supervisory jurisdiction of the courts would be safeguarded if it were provided that in that case the Court of Appeal, on appeal from the award, should have jurisdiction to set aside the award if, in its judgment, the award is unreasonable; the court would then, in accordance with normal practise, give its own decision in the case.[123]

Umpire: The statute of Quebec makes no reference to this type of arbitrator. In Ontario and in the other Common Law provinces, where there are two arbitrators and they cannot agree, an umpire may make the award.[124]

Procedure: In Quebec, the arbitrators follow the procedure determined by the parties.[125] The statute of Ontario makes no reference to the procedure and there are different views regarding the freedom the arbitrators have for appraising evidence. One view is that arbitrators are not strictly bound by the rules of evidence. According to it, they may hear and appraise the worth of evidence that may not be admissible in the court and derive their own conclusions.[126] The other view is that arbitrators appointed under a statute must act in accordance with the essential rules of natural justice unless the parties have agreed otherwise, and they are bound by the same rules of evidence as the ordinary courts.[127]

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[122] *Orion Compania Espanola de Seguros v. Belfort Maatschappij Voor Algemene Verzekeringen* (1962), 2 Lloyd's Rep. 257.
[123] Clive Mc Schmitthoff, "The Supervisory Jurisdiction of the Courts", Journal of Business Law, 1967, p.328.
[124] Schedule A, par. 7 & 8 of the Ontario Arbitrations Act.
[125] Article 943 of the Code of Civil Procedure.
[126] *Re Bondi and Toronto,(1968) 1 O.R. 205 (C.A.)*
[127] *Re McCain and St. John* (1964), 50 M.P.R. 363 (N.B.C.A.).

Reasoned award: In Quebec, the award must contain the reasons for the decision and must be in writing.[128] In Ontario, the Act requires the award to be in writing.[129]

Evidence: Both the statutes from Quebec and Ontario stipulate the way in which evidence will be received.[130]

Special stated case: In Quebec, there is no special case. In Ontario, there are the special cases stated by the arbitrator and the special cases stated by the court. In the first ones, the arbitrator may ask the opinion of the court to determine certain point of law. The arbitrator has the power to refuse the request.[131] In the second ones, a party to the arbitration has the right to make an application to the court to order a special case,[132] and the court has complete discretion whether to issue the order to the parties.[133] However, the court will not consider itself bound by a writtten agreement between the parties not to apply for a stated case.[134]

Term: In Quebec, if the submission does not provide otherwise, the arbitrators must render the award not later than six months after having been seized of the matter.[135] In Ontario, unless the parties agree otherwise, the arbitrators must render the award within three months after entering on the reference.

Appeal: In Quebec, there is no provision for appeal, except under the special chapter on Arbitration by Advocates (in which the award is subject to appeal as an ordinary judgment of the court).[136] In Ontario, an appeal lies to a judge in court and from him to the Court of Appeal, if the parties have agreed on having an appeal to the award.[137]

Setting aside: In Quebec, an action in annulment of the award has been allowed by the court, even though the Code of Civil Procedure does not contemplate it.[138] In Ontario, the court has inherent equitable jurisdiction at Common Law and jurisdiction under the Arbitrations Act to set aside the award.[139]

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[128]Article 943 of the Code of Civil Procedure.
[129]Section 5, Schedule A of the Arbitrations Act.
[130]Quebec: articles 280-284 and 943 of the Code of Civil Procedure. Ontario: Sections 14; 15 (1)(2); 9 Schedule A; 10 Schedule A; 25 and 28 of the Arbitrations Act.
[131]Section 26 of the Arbitrations Act.
[132]Section 26 of the Arbitrations Act.
[133]*Re Can. Line Materials Ltd. and Dom. Cutout Co.* (1960), O.W.N. 168 (H.C.).
[134]*Rathbun Co. v. Standard Chemical Co.* (1903), 5 O.L.R. 286 at 295-6, per Meredith C.J.
[135]Article 941 of the Code of Civil Procedure.
[136]Article 393 of the Code of Civil Procedure.
[137]Section 11(1) of the Arbitrations Act.
[138]*Cite de Montreal v. Paiement* (1919), 28 K.B. 381, 388.
[139]*Re Dowell and Maddleton* (1972), 2 L.C.R. 343, 28 D.L.R. (3d) 612 (N.S.C.A.); *Beach v.*

Enforcement: In Quebec, a foreign award can only be executed under the authority of a court having jurisdiction, and upon motion for homologation to have the party condemned to execute it. In the process of homologation, the court may examine any grounds of nullity which affect the award.[140] The homologation upon motion instead of a normal court action was in effect until 1970. The advantage of the motion is that it may be submitted in the Practice Court at any time, while a court action must wait to be put on the rolls of the court. This means a waiting period of one year or longer. There is another way to enforce a foreign arbitral award in Quebec by an action on exemplification. Exemplification is a complete transcript or reproduction of the jugdment certified to be "under the seal of such court or under the signature of the officer having the legal custody of the record of such judgment or other judicial proceeding."[141] The foreign award is homologated by the proper foreign tribunal and then is enforced in Quebec as a foreign judgment, subject to the rules on enforcement of foreign judgments and not to the rules on enforcement of foreign awards. This action has to be put on the rolls of the court, which is a great disadvantage for the time this procedure takes. Any defence which was or might have been set up to the original action may be pleaded to an action brought upon a judgment rendered outside Canada.

In Ontario, the Reciprocal Enforcement of Judgments Act applies only to awards from other jurisdictions within Canada, not to awards from foreign countries. Foreign arbitral awards may be enforced by a judgment on an action brought under Rule 33 of the Rules of the Supreme Court.[142] This action is called action with a especially endorsed writ and has the advantage that it can be dealt with expeditiously. The plaintiff must show that the parties agreed to submit to arbitration and that the submission was valid. The award must be valid under the law of the country where it was made. The defendant must have been resident of the foreign jurisdiction when the action was commenced against him or he must have submitted to the jurisdiction of the foreign court.

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[139](cont'd)*H.E.P.C.* (1924), 54 O.L.R. 35 at 38, (1927), S.C.R. 251.
[140]Article 950 of the Code of Civil Procedure.
[141]L.W. Johnson, Conflict of Laws, 2nd ed., 1962, p.780.
[142]RSO 1970, Reg. 545.

D. Arbitration in Guatemala

The regulations which are relevant for the arbitration in reinsurance contracts are explained next.

Submission and undertaking: The statute differentiates between a submission to arbitration of existing disputes (in French "compromis") and an undertaking to arbitrate future disputes (in French "clause compromissoire").[143]

. Enforcement of undertaking: If one of the parties refuses to execute a submission to arbitration when the dispute arises, a judge having jurisdiction will appoint the arbitrators and will state the points of the dispute.[144]

Form: The submission has no special requirement concerning its form but it has to be in writing.[145]

Exception to oust the jurisdiction of the court: Wherever there is in existence a submission or an undertaking to arbitrate, and one of the parties institutes an action in a court, the other one may challenge its jurisdiction by means of a preliminary exception.[146]

Number of arbitrators: Unless the parties designate one arbitrator or agree to a judge as appointing one, the number has to be three or five. The arbitrators must be appointed with the agreement of both parties.[147]

Term: Unless the parties agree otherwise, the term for rendering the award is one hundred days.[148]

Evidence: The arbitrators are empowered to receive any kind of evidence and the procedure to be followed is the one set in the Code of Civil and Mercantile Procedure for the general rules of evidence.[149]

Form of the award: It must be in writing, and the reasons for it must be set out in order to use the recourses of amplification and clarification. It must also be rendered in the presence of a Notary Public, who has to sign it together with the arbitrators.[150]

Revocation of appointment: The arbitrators may be dismissed by agreement of

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[143]Articles 269 and 670 of the Code of Civil and Mercantile Procedure.
[144]Ibid, article 271.
[145]Article 671 of the Code of Commerce.
[146]Article 276 of the Code of Civil and Mercantile Procedure.
[147]Ibid., article 277.
[148]Ibid., article 274.
[149]Ibid., article 288.
[150]Ibid., article 292.

both parties.[151]

Capacity to act as arbitrator: The Code of Commerce specifically establishes that the arbitrators must be experts on the matter of reinsurance.[152] This provision excludes the application of article 278 of the Code of Civil and Mercantile Procedure. This Code refers to two kinds of arbitration: arbitration in law and arbitration in equity. In the former, the arbitrators must be advocates or notaries public and must follow the procedure set in the Code. In the latter, the arbitrators are amiable compositeurs and will decide according to equity. The amiable compositeurs do not have to follow the procedure set in the Code, but must give to each party an opportunity to be heard and present evidence. They are laymen, not advocates.[153]

The reinsurance arbitration, according to the Guatemalan statutes, may be considered as an arbitration of law because the Code expressly stipulates that the arbitrators shall decide according to the usages and practices of reinsurance internationally accepted. Customs and usages are not a source or law unless the statutes provide otherwise. In this case, the Code of Commerce expressly provides that the usages and customs are sources of law and binding on the arbitrators. The wording of the Code seems imperative and, therefore, the parties could not agree on an arbitration in equity.

The classification of the reinsurance arbitration as an arbitration in law is relevant when the arbitral procedure is to be followed in Guatemala. Usually, reinsurance contracts provide that the arbitrators shall interpret the contract as an honourable engagement not subject to the strict rules of law and provide for a special procedure. Since the procedure of the arbitration of law is imperative and cannot be changed by will of the parties, such provision is most likely not to be accepted by the Guatemalan courts. An award rendered by such a procedure can be attacked on the grounds of violation of procedure.

Setting aside the award: The grounds for setting aside an arbitration in law are the same grounds as for attacking a judicial decision: violation of law and error in the

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[151] Ibid., article 283.
[152] Article 1022.
[153] The requisites for the arbitration in law are set in articles 277 and 288 of the Code of Civil and Mercantile Procedure. The arbitration of equity is regulated by article 289 of the same Code.

procedure. The petition for setting aside the award is directed to the Supreme Court.

Enforcement: In order to enforce an award, the party who wants to execute it must bring an homologation motion before the court. The defences available to the other party are restricted to those exceptions known after the commencement of the action and which are contained in a document.[154]

Intervention of a Notary Public: All the acts and resolutions of the arbitral tribunal shall be made with the intervention of a Notary Public who certifies their authenticity.[155]

Conclusion

The statutes of Quebec and Guatemala are similar because both correspond to civil law systems. Likewise, the statutes of the Common Law provinces are similar. The main difference between the common and civil law statutes is the supervisory jurisdiction of the courts in the arbitral procedure. The Common Law provinces have the procedure of the stated case which allows the parties to ask for the opinion of the court when there is a controversial point of law. There is no such procedure in the civil law statutes. The arbitrators are the only ones who decide the points of law and their decision is reviewed by the court when one of the parties institutes an action to set aside the award. The stated case procedure has the main disadvantage of delaying indefinitely the arbitral proceedings because either party may ask for the opinion of the court on any minor point of law that could arise.

Another difference between the civil and Common Law statutes is the appeal. In Guatemala and in Quebec, the statutes do not provide for an appeal of the award. In the Common Law provinces, there can be an appeal of the award only if the parties have agreed on it.

The interpretation of the reinsurance contract as an honorable engagement not subject to the strict rules of law would not be accepted in Guatemala (because the arbitrators must apply the usages and practices internationally accepted in the industry of reinsurance) either in the Common Law provinces (because the arbitrators must apply rules of law), only in Quebec.

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[154]Articles 293 and 296 of the Code of Civil and Mercantile Procedure.
[155]Ibid., article 291.

The type of arbitrator called 'umpire' is mentioned in the statutes of Quebec, but not in the statutes of Guatemala or the Common Law provinces.

The arbitration clause given as an example in chapter IV is an undertaking to arbitrate future disputes. Both in Canada and in Guatemala the parties are able to enforce this submission. The arbitration procedure in that clause, if followed in Guatemala, would not be accepted by the courts because the reinsurance arbitration proceedings are considered as arbitration of law and must follow the procedure established by the statutes. In Quebec and in the Common Law provinces, it would be accepted because their statutes do not require a special procedure for reinsurance arbitration.

E. Enforcement of Foreign Awards in Canada

The Uniform Law Conference of Canada prepared in 1924 a model Reciprocal Enforcement of Judgments Acts which unifies the rules of practise relating to foreign judgments (including arbitral awards) and facilitates their enforcement. This Act has been adopted by all Common Law provinces and territories. The Reciprocal Enforcement of Judgments Acts of the provinces of Alberta, British Columbia, Manitoba , Newfoundland and Nova Scotia apply to foreign judgments obtained in another country. In any case, the judgment must have been given in a reciprocating jurisdiction. A reciprocating jurisdiction is defined by the Nova Scotia Act as the territorial legal unit in Canada or outside Canada that is declared by the Governor in Council as such for the purpose of the Act.[156] However, the Act does not alter the rules of conflict of laws as to the recognition to be given to foreign judgments. The Act preserves the judgment creditor's right to bring an action on his judgment, or on the original cause of action, instead of proceding under the Act even after proceedings have already been taken under the Act.[157] The Conference also recommended that the provinces adopt a Uniform Foreign Judgment Act in which the

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[156]Section 2 (h). British Columbia made an order in council in regard to the Federal Republic of Germany.

[157]Castel, Introduction to Conflict of Laws, p.89.

condition of reciprocity would not be necessary. This Act has been only adopted by Saskatchewan and New Brunswick.[158]

The first step to follow for a judgment creditor is to apply, within six years after the date of the judgment, to the Supreme Court or to a district court of the province in which registration is sought, for an order for registration.[159] The judgment debtor may apply within one month to have the registration set aside upon any of the grounds listed in the Act.[160] The grounds for setting aside the registration are the same as the ones for the original action.[161] In his application, the judgment debtor must state, in the notice of motion, all the grounds upon which the foreign judgment should not be registered. The foreign judgment is, from the date of registration, of the same force and effect as if it were a judgment of the registering court.[162] If an application for registration is made ex parte, notice must be given to the judgment debtor within one month and he will have a period of one month to move to set aside the registration.[163] An ex parte application cannot be made unless the judgement debtor was personally served or appeared or submitted in connection with the original action.[164]

There is no reciprocity between Guatemala and Canada under the Reciprocal Enforcement of Judgements Acts. Only in Saskatchewan and in New Brunswick could an arbitral award from Guatemala be enforced. Otherwise, in the other provinces and territories, a foreign award could be enforced only under the Common Law rules of recognition and enforcement.

The first thing to be noted is that, in Canada, a foreign judgment does not merge the original cause of action.[165] Therefore, the plaintiff may bring an action on the original cause, on the foreign judgment or in one action request for the enforcement of the

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[158]The province of New Foundland has adopted the Arbitration Foreign Awards Act (1931 22 Geo V ch. 2) whereby the Protocol and the Convention of Geneva were made applicable in the province. The reason for this situation is that New Foundland joined Canada until 1949. Before, it belonged to the British Commonwealth and since England had signed those treaties, they were and are still effective in New Foundland.
[159]R.S.A., 1970, c.312, s.3(1).
[160]Ibid, s.7(1)b(2).
[161]Ibid.,s.3(6).
[162]Ibid., 6(a).
[163]Ibid., s.6(a).
[164] Ibid., s.2(1)(a) and s.3(2).
[165]*Barned's Banking Co. Ltd. v. Reynolds* (1875), 36 U.C.Q.B. 256 at p.289; *Trevelyan v. Meyers* (1895), 26 O. R. 430; *Clergue v. Humphrey* (1900), 31 S.C.R. 66; *Moritz v. Canada Wood Co.* 17 O.L.R. 53, affd. 42 S.C.R. 237; *Industrial Acceptance Corp. Ltd. v. Stevenson* (1963), 43 W.W.R. 126 (Sask. Q.B.).

foreign judgment, or alternatively, sue on the original cause of action.

The second thing is that in order to enforce a Guatemalan arbitral award, the plaintiff must first homologate it in a Guatemalan Court. Logic J., in the case of *Stolp & Co. v. W.B. Browne & Co.*[166] stated that a foreign arbitral award must be first made an order of the foreign Court in order to amount to a judgment. Then, it is merged in that order which is in effect the judgment of the Court in the matter.[167]

The three conditions that Canadian courts require in a foreign judgment in order to enforce it are:

1) Competent international jurisdiction: The case of *Emanuel v. Symon* [168] established five cases in which the Courts would enforce a foreign judgment in actions in personam: (1) when the defendant is a subject of the foreign country in which the judgment has been obtained; (2) where he was resident when the action began; (3) where the defendant in the character of plaintiff has selected the forum in which he is afterward sued; (4) where he has voluntarily appeared; and (5) where he has contracted to submit himself to the forum in which the judgment was obtained.

In reinsurance contracts, if the parties agree to submit their disputes to arbitration in Guatemala, then this choice of forum would be regarded as indicative of the procedure to govern the arbitration, at least when no other procedure is mentioned.[169] Logically, it follows that where the procedure is governed by Guatemalan law, Guatemalan courts would have jurisdiction, too, whenever their intervention is needed, especially for homologating the arbitral award and in order to enforce it in Canada as a foreign judgment. This inference is affirmed by the statement that a forum selection agreement has long been recognized and has been said to be a prima facie justification for the grant of a stay of proceedings.[170] Also, if the Canadian party to the contract appears voluntarily in the arbitration proceedings being followed in Guatemala, although no choice of forum was made, this appearance would meet the requirements of case (5) above. As a practical consideration, the most probable cases that would apply to a Guatemalan–Canadian reinsurance contract would be (4) and (5) above.

166(1930), 4 D.L.R.; 66 O.L.R. 73; 38 O.W.N. 400, (O.S.C.).

167He relied in Piggott's Foreign Judgments and Jurisdiction, pp.95–96.

168(1908), 1 K. B. 302 at 309 (C. H.)

169*James Miller & Partners v. Whitworth Street States* (1970), A.C. 583 (H.L.).

170*Fehmarn (Cargo, etc.) (Owners) v. Fehmarn (Owners); The Fehmarn* (1957), 1 W.L.R. 815 at 819, affd. (1958), 1 W.L.R. 159 (C.A.).

2) Definite and ascertained sum.[171]

3) Final and conclusive judgment: When the judgment is subject to modification or alteration by the court which granted it, it is not final.[172] If the judgment would be subject to an appeal in another court, it would be final and conclusive.[173] However, if the law where the judgment was granted stipulates that a pending appeal suspends the force of a judgment, then it is not final and conclusive.

What are the defences available to prevent the enforcement? The defendant may argue that the conditions mentioned before are not met, that there was fraud in procuring the judgment, that the proceedings in which it was rendered were contrary to the principles of natural justice or that it was contrary to the public policy of the forum.

As to fraud, there is no consensus in determining the fraud that would render a foreign judgment inconclusive. In Ontario, the Court of Appeal in *Jacobs v. Beaver Silver Cobalt Mining Co.*[174] limited the defense of fraud to cases where the defendant was deprived of an adequate opportunity to present the case to the foreign court, and when he knew of the fraud after the proceedings, having no chance to reopen the case abroad. The decision is disregarded if the foreign court acted fraudulently.[175]

As to natural justice, it refers to irregularities in the procedure of the foreign court which have a serious repercussion. A mere irregularity of procedure will not be regarded as contrary to natural justice.[176] There is a lack of natural justice where the defendant receives no notice or receives inadequate notice of the trial, preventing him from being heard or from having an opportunity to present his case.[177] The lack of natural justice is never presumed.[178] The defendant has the onus to prove that he was not served and received no notice of the foreign suit.[179]

As to public policy, a foreign judgment would not be enforced if it is contrary to the public policy of the forum, or, in other words, if the policy of the recognizing forum

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[171] *Sadler v. Robins* (1808), 170 E.R. 948.
[172] *Nouvion v. Freeman* (1889), 15 App. Cas. 1 at 9 (H.L.).
[173] *Barned's Banking Co. v. Reynolds* (1875), 36 U.C.Q.B.
[174] (1908), 17 O.L.R. 496, 12 O.W.R. 803 (C.A.).
[175] *Price v. Dewhurst(1837), 8 Sim. 279, 6 L.J. Ch.226, affd. on other grounds (1838), My. & Cr. 76.*
[176] *Pemberton v. Hughes* (1889), 1 Ch.781, 68 L.F. Ch.281 (C.A.).
[177] *Delaporte v. Delaporte* (1927), 61 O.L.R. 302, (1927), 4 D.L.R. 933, *Jacobson v. Franchon* (1927), 44 T.L.R. 103 (C.A.).
[178] *Henderson v. Henderson* (1844), 6 Q.B. 288, 13 L.J.Q.B. 274.
[179] *Romano v. Maggiora* (1936), 50 B.C.R. 66, (1935) 2 W.W.R. 524.

would be affected. Some reasons would be the illegality of the transaction in the forum, the effect on the forum's relations with other countries,[180] and a lack of fundamental fairness.[181]

In Quebec, the award of arbitration can only be executed under the authority of a court having jurisdiction and upon motion for homologation to have the party condemned to execute it The court may examine the grounds of nullity of any question of form that may prevent its homologation but it cannot enquire into the merits of the contestation.[182] The homologation upon a motion instead of a normal court action was introduced by a law assented to on June 30, 1970. As is the case in Guatemala, the Code of Civil Procedure of Quebec does not differentiate between foreign or domestic awards.[183] The court in Quebec that homologates the award must have jurisdiction. The territorial jurisdiction is determined by articles 68 and 75 of the Code of Civil Procedure.

As mentioned before, an award can also be homologated by a proper foreign tribunal. The judgment will be subject to the rules on enforcement of foreign judgments by an action on exemplification.[184]

The grounds to contest a foreign judgment are the grounds which could have been successfully raised in the jurisdiction in which the original action was instituted, whether the defendant raised them before the foreign jurisdiction or not.[185] Therefore, in Quebec it seems more advisable to submit a motion to homologate the award instead of instituting an action on exemplification of the foreign judgment, even when the award has been homologated abroad.

F. Enforcement of Foreign Awards in Guatemala

Neither Guatemala nor Canada are parties to the New York Convention of 1958 for the Recognition and Enforcement of Foreign Arbitral Awards[186] or the Geneva Convention of 1961.[187] Therefore, the law of the jurisdiction where the award is to be enforced has to

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[180] *Foster v. Driscoll* (1929), 1 K.B. 470 (C.A.)
[181] *Middleton v. Middleton* (1967), P.62.
[182] Art. 950 of the Code of Civil Procedure.
[183] Arts. 178-181 of the Code of Civil Procedure.
[184] Art. 1220, par.1 of the Civil Code.
[185] *Orsi v. Irving Samuel Inc.*(1957) Que. Superior Court 209 at p.211.
[186] (1959), 330 U.N.T.S. No. 4739.
[187] (1963-64), 484 U.N.T.S. 349.

be studied.

The Guatemalan statutes do not distinguish between foreign and domestic arbitral awards when they refer to the enforcement of the awards. However, when the statutes refer to the enforcement of the arbitral awards, they mention that the award must be final and not subject to a recurso de casacion (in French 'recours de cassation') which is a recourse not provided for in the Common Law statutes. This fact may suggest that the enforcement of arbitral awards is only for domestic awards. The only reference to the enforcement of foreign arbitral awards is found in article 432 of the Code of International Private Law[188] which does not apply to the relations between Canadians and Guatemalans and in the Interamerican Convention for Commercial Arbitration of 1975.[189] Since the statutes do not distinguish between foreign and domestic arbitral awards, the question that arises is whether the tribunals will enforce a foreign award which has not been homologated by the competent tribunal of the foreign jurisdiction. Assuming that the courts would enforce a foreign award (homologated or not), the following requisites would have to be met:

1) All the requirements of form, content and procedure according to the provincial statutes must be complied with.[190]

2) The award must not be contrary to the Constitution, the statutes and public policy.[191]

3) A certified copy of the award must be legalized by the Minister of External Relations of Guatemala and translated to Spanish by an official translator.[192]

4) The award must be final according to the provincial legislation that was applied.[193]

5) The procedure for enforcing the award must be initiated within five years from the date it was published.[194]

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[188]This Code is a convention ratified by the Latin American countries in order to regulate private international relations between their citizens, the 13 of February, 1928 in La Havana, Cuba.
[189]This convention was signed by the members of the Organization of American States.
[190]Article 20 of the Law of the Judiciary.
[191]Ibid., article 23.
[192]Ibid., article 190 and 295 of the Code of Civil and Mercantile Procedure.
[193]Article 293 of the Code of Civil and Mercantile Procedure. In common law, final means that there is no pending action for impeachment or setting aside the award.
[194]Ibid., article 296.

There is a specific section dealing with the enforcement of foreign judgments.[195] This section applies when the foreign award has been made an order of the court where the award was rendered. The requisites for enforcing a foreign judgment are the following:

1) There must be reciprocity between Canada and Guatemala. This means that a Canadian judgment in Guatemala will be given the same efficacy as a Guatemalan judgment receives in Canada.

2) The judgment must be entered in a commercial or civil action.

3) The judgment must not be in default or against a person deemed to be absent from, but domiciled in Guatemala.

4) The obligation which is the subject of the action must be legal in Guatemala.

5) The judgment must be final according to the provincial legislation and must have been entered according to the provincial legal requisites.

If these requirements are met, the procedure for enforcing a foreign judgment is the same as for a domestic judgment and a domestic (and possibly a foreign) arbitral award. It is a special summary procedure in which the only defences available are the ones that destroy the efficacy of the judgment or the award.[196]

Conclusion

In general terms, the requirements for enforcing foreign judgments and foreign awards in Guatemala and Canada are similar. The fact of not making any distinction between domestic and foreign awards is a logical consequence of the nature of arbitration. The resolution of disputes by means of arbitration is a private procedure with tribunals constituted under the law by the parties. These tribunals do not have nationality in the sense that they are not part of the judicial system of a particular state. Therefore, the distinction between domestic and foreign awards does not have any practical purpose. The statutes of Guatemala and Quebec do not differentiate expressly between foreign and domestic awards and the question remains as to whether foreign arbitral awards could be enforced, without first being homologated. In the Common Law provinces, awards from

[195] Ibid., articles 344 and 345.
[196] Articles 294 and 295 of the Code of Civil and Mercantile Procedure.

the other jurisdictions within Canada may be enforced under the Reciprocal Enforcement of Judgments Acts. The foreign arbitral awards from jurisdiction outside Canada may be enforced under the Common Law rules of recognition and enforcement of foreign judgments. Therefore, foreign arbitral awards have first to be made orders of the court of the countries in which they were rendered in order to be enforced in Canada as foreign judgments. Only in New Brunswick, Saskatchewan and Newfoundland is there a possibility of enforcing foreign arbitral awards as awards and not as foreign judgments.

The general requisite to enforce a foreign judgment in Guatemala is that it must be final and must have complied with all the legal requisites of the province where it was rendered. This condition seems to embrace all the requisites needed to enforce a foreign judgment in the Common Law provinces. Since the statement contained in the Guatemalan statute is general, the judge has complete discretion to assess if the foreign judgment has complied with the legal requirements of the province where it was rendered. The difference with Canada is that, in the latter, the jurisprudence has determined which situations are included in the three conditions required for enforcing a foreign judgment.

If the foreign arbitral award is going to be enforced as such and not as a foreign judgment in Guatemala, then the requirements are that it should be final and for a definite amount of money.

VIII. Conclusion

1) Reinsurance is a contract where the principle of utmost good faith plays the most important role. It is considered to be an honourable or gentlemen's agreement in which the intention is to interpret the contract according to practical business and equity considerations. Due to the fact that reinsurers know nothing or very little about the risks transferred to them (except in the case of facultative reinsurance), the highest duty of good faith rests on the ceding company. If ceding companies do not continue to observe this principle, the reinsurance industry will not be able to continue to operate as it has done up to this time. Reinsurers would have to implement some type of controls and restrictions to protect themselves from unfair dealing, and these would directly affect the original insureds.

2) The business of reinsurance is worldwide and, therefore, highly international. A single country does not have enough capacity or capital to allow the theory of the law of large number to operate effectively without resorting to reinsurace. Reinsurance is a means to balance the exposures of one society against the perils present in another. Reinsurance companies are essential for insurers. Without them, insurers would be limited to undertaking risks within their capacity, would have no stabilizing mechanism for the control of their losses and would not have access to the advice of highly-qualified experts. The relation between insurers and reinsurers is of great benefit to the former ones and overall, the primary insureds are benefited because the insurance companies have the backing of a strong company.

3) As it has been seen with the examples of Canada and Guatemala, the reinsurance market is free to determine its own operation. The primary insurance industry, which is dealing directly with the public, is extensively regulated. The state protects the insurance-consumer public through legislation because normally it is in a position of disadvantage vis-a-vis the insurers. In the case of insurer-reinsurer relation, both parties are experts on the matter and do not require the protection of state authorities. To what extent is this laissez-faire attitude toward reinsurance a sound one? Time and experience have shown that official intervention is not necessary and that the reinsurance market has

been able to develop itself efficiently. However, in the case of foreign reinsurers transacting business in a certain country without having assets in it to cover the risks accepted, there is a need on the part of the state to achieve a certain measure of control. This control depends upon the conditions of each country and cannot be so strict as to hinder the effective spreading of the risks. Factors such as the political and economical situation of the native country of the reinsurer and of the countries in which it operates have to be taken into account. For example, in Guatemala and in Canada reinsurers without assets in these countries are able to operate. There is no case in recent times in which a main foreign reinsurer has become insolvent and incapable of paying for its share of the risks. If a law is passed compelling foreign reinsurers to invest sufficient assets in those countries to cover the risks transferred to them, unfavourable consequences may follow. Reinsurers may not want to invest in a country because of its political or economical situation and because investing either directly or indirectly in the physical assets which they are either directly of indirectly reinsuring exposes them to disastrous consequences in the form of double losses. The first ones to be affected would be the primary insurers that would not be able to obtain the reinsurance they need, and, finally, the insurance-buyer public. On the other hand, authorities may want to secure assets of the foreign companies doing business in the domestic territory in order to have a guarantee in case of insolvency. The possibility of insolvency for reinsurers is real for three main reasons: a) the reinsurance business is international and subject to economical and political disruption; b) consecutive extraordinary catastrophes, man-made or natural, could have a tremendous impact on reinsurers; and c) inflation and other manifestations of economic crisis may have a very serious effect.[197] These two opposite views must be reconciled in some kind of preventive, moderate and realistic solution. It has to be borne in mind that as long as both parties adhere to the principle of utmost good faith, only conditions such as the ones mentioned before may cause the reinsurer to become insolvent.

4) Arbitration is the other special characteristic of the reinsurance industry. The parties prefer to have their disputes solved by experts on the matter and away from the publicity of the courts. Arbitration has contributed to keep the relations of the parties on good terms, because it provides an amicable setting for the resolution of conflicts. Since

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[197]David Thompson, "Critical Issues of the Eighties: How Trends in Reinsurance Will Affect Legal, Legislative and Regulatory Actions," Forum, vol. 16, 1980-81, part 2, p. 1045.

the arbitration clause is very important, extreme care must be taken in the drafting, after a study of the different legal systems involved. For example, in the Common Law provinces of Canada, the provision stating that the arbitrators will interpret the contract as an honourable engagement and will not be bound by the strict rules of law, would not accepted by the courts. Arbitrators must apply rules of law in making the award. Similarly, it would not be accepted in Guatemala either, for the arbitrators must decide according to the customs and usages internationally accepted. However, as was mentioned before, if the fact of interpreting reinsurance contracts as an honourable engagement can be proved to be an accepted international custom, then this interpretation would be available. In the last instance, the outcome of the arbitral proceedings will depend on the place they are being held. If they are held in Guatemala and the reinsured is a Guatemalan company, the arbitrators would follow the Guatemalan procedural law and the Guatemalan substantive law. The reason for this is that in Guatemala the law of the place of performance governs the contract and the law of the place where the action is commenced governs the proceedings. If the arbitration proceedings are held in Canada, the arbitrators would apply the test of the closest and most real connection and would find that the proper law of the contract is Canadian law where there is no express choice of law. The procedure to be followed is usually stated in the arbitration clause and the rules of law must be applied in the decision. The enforcement of arbitral awards in Guatemala and Canada is different because neither of them are parties to the New York Convention of 1958 or the Geneva Convention of 1961.

5) One of the major problems for the reinsurers is the request of the ceding company to contribute to the payment of extracontractual (punitive) damages.[198] There are two sources of punitive damages for the insurer. First, when the damages are assessed against the insured, the insurer is held liable because of its contractual relation with the insured. In this case, the reinsurer shares the cost of the "excess policy limits judgment" because the obligation arises from the contractual obligation of the insurer, a share of which has been ceded to the reinsurer. Second, when the insurer has committed an independent tort against its own insured, reinsurers take the position that they are not liable for tortious acts committed by persons over whom they have no control or

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[198]Punitive damages have been recognized in Common Law since 1763. *Wiles v. Wood*, (1763), Lofft 1, (C.P.); *Huckel v. Money* (1763), 2 Wils K.B. 205.

supervision.[199] The big punitive damages awarded by the courts are of concern for both the insurers and reinsurers and this important issue has to be solved by negotiation rather than by litigation.

6) The practices of reinsurance are similar all over the world because of the structure of the market. The few large reinsurers in the world control the largest part of the market, and the industry in general has been free from state regulation to develop its own practices.

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[199]In *Employers Reinsurance Cor. v. American Fid. & Cas.* (1959), 196 F. Supp. 553 (E.D.Mo.), it was held that the liability of the reinsurer arises only from contractual obligations and not from the tort liabilities of the insurer.

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Appendix 2: Cases in Reinsurance

There are few judicial cases dealing with the contract of reinsurance because of the arbitration clauses contained in most reinsurance contracts, except in the facultative ones. Some of the most important cases which apply to Canadian reinsurance industry are described below.

The Great Lakes Reinsurance Company et al v. Cyr[200]

Following an automobile accident, the plaintiff obtained a judgment against C, the owner of the automobile who later was declared in bankruptcy, and whose insurer, the company PN, was ordered to be wound-up. The insurer had signed a contract of reinsurance with the company GL, covering 75 per cent of the total liability, and another contract with the company L for all losses in excess of $12,500. The plaintiff took a seizure by garnishment against GL and the agent of L. Both garnishees made a negative declaration which was contested. The Superior Court and the Court of Appeal dismissed the contestation of the garnishees' declaration. The plaintiff appealed. It was held on appeal that the company GL was not a co-insurer. The insurance policy in favour of C mentioned only the name of the company PN. It was not possible to find in the reinsurance contracts anything capable of being interpreted as a stipulation for the benefit of third persons, in this instance the insured of the company PN. As a creditor of C, the plaintiff could not exercise the rights conferred by art.1031 of the Quebec civil code. The record disclosed that the liquidator of the company PN was specifically authorized by the court having jurisdiction over the winding-up to put in a claim for any moneys owed by the garnishees.

The contracts of reinsurance were not in this case contracts of partnership. The contract with the company L did not provide for participation in the profits. As to the company GL, the mere fact of the participation on the profits of a company did not create a presumption of partnership. In the present case, the intention was to make a contract of reinsurance. The company GL had no intention of assuming all of the obligations of the company PN. Moreover, it intended to oblige itself only towards the company with which it was contracting and not towards the insured of the latter. It is settled by the

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[200](1969) R.C.S. 342.

jurisprudence of the Common Law, the rules of which respecting the formation of a contract of partnership appear to be identical with the rules in Quebec, that a contract of reinsurance with the participation in the profits does not constitute a contract of partnership.

Br. Traders Ins. v. Queen Ins. Co.[201]

N. Co. applied to plaintiff insurers for fire insurance on certain premises. Plaintiff asked defendants to reinsure part of the risk; and it was found on oral evidence and correspondence that defendants agreed to a line of reinsurance; whereupon plaintiffs accepted N. Co's proposal. The arrangement between plaintiffs and N. Co was entirely verbal; and a fire occurred before a policy could be issued. It was held that there was a completed contract of insurance between plaintiffs and N. Co.; and the defendants were liable for the reinsurance. Viewing the transaction between plaintiffs and defendants as amounting only to an offer by the latter to undertake reinsurance, to the extent stipulated, of further risks to be assumed by the plaintiffs, the principle of *Carlill v. Carbolic Smoke Ball Co.,*[202] applied; the performance of the condition completed the contract and the notification of acceptance was dispensed with. In the circumstances, the nature of defendants' undertaking implied that their obligation was to arise immediately upon the plaintiffs becoming committed to liability.

Prov. Ins. Co. v. Aetna Ins. Co.[203]

A reinsurence policy expressly provided that no action should be maintained thereon except within twelve months next 'after any loss or damage shall occur'. It was contended that the 'loss or damage' meant, not the loss of property insured, but the loss or damage sustained by the original insurers, which occurred as soon as they paid the money under the original insurance, and that time began to run from that date. It was held that this contention failed; the words 'after any loss or damage shall occur' could only be taken to refer to the casualty insured against.

Federal Ins. Co. v. Westchester Fire Ins. Co.[204]

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[201](1928) S.C.R. 9.
[202](1893) 1 Q.B. 256.
[203](1858) 16 U.C.Q.B. 135 (C.A).
[204](1929) 3 W.W.R. 646, 24 Alta.L.R. 330.

Plaintiffs insured certain crops against loss by hail. In the application the applicant was required to, and did, disclose the fact that his crops had been visited by hail storms twice in the same season. The plaintiffs, without disclosing this fact, obtained reinsurance from the defendants. The defendants' reinsurance policy was expressed to be subject to the conditions on the back thereof; and the conditions on the back were the Alberta statutory conditions relating to hail insurance. The printed form was the one used for the original insurance. The trial Judge dismissed plaintiffs' actions on the reinsurance contract, for failure to disclose the previous hail storms. On appeal, it was held that the appeal should be dismissed. Per Clarke J.A.:

> It is argued on the authority of *Home Insurance Co. v. Victoria-Montreal Fire Ins. Co.*,(1907) A.C. 59, 16 Que. K.B. 31, that the statutory conditions or some of them are not applicable in case of reinsurance –but without having to decide that question it should be noted that s.292 of the Alberta Insurance Act, 1926, c.31, provides that the statutory conditions in schedule F. shall be deemed to be part of every contract in force in Alberta with respect to any crop therein. Apart, however, from the statutory conditions, I think that on general principles of law relating to insurance contracts it is well settled by authority that failure to disclose a material fact invalidates the policy, not only in case of original insurance but of reinsurance as well, in the latter case the original insurer being himself the assured. In my opinion the existence of the previous hail storms was a fact material to the contract of reinsurance; it was so regarded by the plaintiff in regard to the original insurance and as the reinsuring company undertook the same risks, I can see no reason why the same rule of disclosure does not exist in one case as much as in the other.

Home Ins. v. Victoria-Montreal Fire Insur. Co.[205]

The insurance was effected by attaching to a printed form of fire insurance policy a typewritten slip or rider containing the special terms of the so-called reinsurance. The printed form was not amended except by the insertion of the syllable "re" before the word "insure" thus substituting the expression "does reinsure" for "does insure." Among the separate stipulations or clauses in the printed form there was the following: "No suit or action on this policy for the recovery of any claim shall be sustainable in any Court of Law or Equity until after compliance by the insured with all the foregoing requirements, nor unless commenced next within twelve months next after the fire." Lord Macnaghten said:

> A clause prescribing legal proceedings after a limited period is a reasonable provision in a policy of insurance against direct loss to specific property. In such case the insured is master of the situation. He can bring his action immediately. In a case of reinsurance against liability the insured is

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[205](1907), A.C. 59, 76 L.J.P.C. 1.

> helpless. He cannot move until the direct loss is ascertained between parties over whom he has no control and in proceedings in which he cannot intervene. If the respondents are right, a honest claim might be defeated in such case as this without any default or delay on the part of the insured, owing to unavoidable difficulties or complications, or possibly in consequence of some dilatory proceedings prompted by the very person in whose favour time is running. In the result their Lordships have come to the conclusion that according to the true construction of this instrument, so awkwardly patched and so carelessly put together, the condition in question is not to be regarded as applying to the contract of reinsurance. To hold otherwise would in their opinion be to adhere to the letter without paying due attention to the spirit and intention of the contract. The question does not seem to have been raised before this in Canada. In the United States, though the point has not been brought before the Supreme Court the universally accepted opinion appears to be that a clause such as that in question is not applicable to a reinsurance policy, and there are several decisions to that effect.

Fire Ins. Assn. and Dom. Fire etc. Ins. Co v. Can. Fire etc. Ins. Co.[206]

In this case, it was held that an original assurer, being at liberty to reinsure the whole of its risk, could after reinsuring half of its risk under two policies, assign its business to another insurer so that the assignee could sue the reinsurer on the contracts of reinsurance. It was held further that the statutory conditions of the Fire Insurance Policy Act, R.S.O 1877, c.162, were designed to protect the owners of property against unreasonable conditions. They were not intended to apply to a contract of reinsurance. Although the original insurer could not act so as to substantially alter the nature or the extent of the risk to the prejudice of its reinsurer, it could waive conditions and make other *bona fide* arrangements with the insured in the same way as any insurer might do in the reasonable exercise of its discretion.

Canada Fire and Marine Ins. Co. v. Northern Ins. Co. of Aberdeen and London. [207]

The plaintiffs' agents reinsured the defendants, another insurance company, for a portion of their risk on property belonging to H & Co., in November, 1875, being well acquainted with the property and every circumstance necessary to consider in deciding whether to accept or reject the risk. He renewed the insurance on the 10th March, 1876, at eight per cent, but swore that he was induced to accept seven per cent premium on the 25th April, owing to a misrepresentation by the defendants' agent that the defendants and

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[206](1883) 2 O.R. 481 (C.A.).
[207](1878), 2 O.A.R. 373.

the other insurance companies holding risks on the property had reduced their rate from eight to seven per cent. It was held that such representation, if made, could form no ground for avoiding the policy, in as much as the plaintiffs had already accepted the risk on their own judgment of its nature, and the misrepresentation could only have had the effect of inducing them to take a lower premium. One of the conditions of the policy was: "This reinsurance is subject to the same specifications, terms and conditions, as policy numero 434.292 of the Northern, which it reinsures; it being well understood that the Northern Insurance Company does not retain an amount equal any sum or risk on the property covered by this policy but retain an amount equal at least thereto on other parts" of the property. The defendants then held three policies on different portions of H & Co's property, which they reinsured in full with the plaintiffs for $2,500 and two others for $2,500 each. It happened that before the fire occurred, one of the defendants' policies for $2,500 expired, so that at the time of the fire they only had a risk on the property of $2,500, over and above their reinsurance. H & Co. did not desire to renew the other policy, and defendants paid the whole $2,500 on the policy in force, while the claim against the plaintiffs was only $2,200. It was held that the defendants had not violated the condition, as the effect of it merely was that they were not to reinsure so as to reduce their own risk below the stipulated amount. It was also held that the difference in the rate of the premium was not such a departure from the "specifications , terms, and conditions" of the defendants' policy as to vitiate the plaintiffs' policy.

Australian Widows' Fund Life Assurance Society, Limited v. National Mutual Life Association of Australasia, Limited.[208]

By a policy dated January 2, 1908, the respondents insured the life of M. The policy provided that certain written statements made by M. as to his health should be the basis of the contract, and that the policy should be void if they were untrue. By a proposal form of the same date the respondents applied to the reinsurers. They accepted the risk on the same terms and conditions as those on which the policy had been granted by the respondents, "by whom, in the event of claim, the settlement will be made." The appellants issued a policy of reinsurance, but limited to the amount which the respondents should pay

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[208](1914) A.C. 634 (P.C.)

irrespective of any bonus. The policy recited that the written statement of M. was the basis of the contract, also that the appellants had agreed to accept the respondents' proposal. M. died, and a claim was made against the respondents by his executrix. The appellants informed the respondents that they had reason to believe that some of the statements made by M. were untrue and warned them that they would not acquiesce in a settlement of the claim. The insurers, however, paid an amount in settlement of the claim and sued the reinsurers upon the policy of reinsurance. The jury found that certain of M.'s statements were untrue and that he had been guilty of concealment and misrepresentation, but that the respondents, in settling the claim, had acted reasonably and bona fide.

Lord Parker of Waddington delivered the judgment of their Lordships. He held that the jury, having found those statements to be false, the provision in the reinsurance contract (stipulating that it was subject to the same terms and conditions as those of the insurance policy) could not alter the express terms of the policy which warranted the truth of M.'s statements. That provision was ambiguous and could not contradict the express provisions of the policy. Therefore, the reinsurer was not liable to pay.

Orion Cia Espanola de Seguros v. Belfort Maatschappij Voor Algemene Verzekeringen [209]

The disputes arose out of a contract made between the parties described as "Quota-Share Non-Marine Reinsurance Treaty". The Belgian insurance company (the reinsurer) motioned to set aside an award made by an umpire in the arbitration proceedings, in favour of the Spanish company (the reinsured). The contract contained an arbitration clause which partially read:

> The Arbitrators and Umpire are relieved from all judicial formalities and may abstain from following the strict rules of law. They shall settle any dispute under the agreement according to an equitable rather than a strict legal interpretation of its terms and their decision shall be final and not subject to appeal.

Mr. Justice Megaw concluded that

> Arbitrators must apply a fixed and recognizable system of law which primarily and normally would be the law of England and that they cannot be allowed to apply some different criterion such as the view of the individual arbitrators or umpires on abstract justice or equitable principles, which, of course, does not mean "equity" in the legal sense of the world.

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[209](1962) 2 Lloyd's Rep. 257

> If the parties choose to provide in their contract that their rights and obligations shall not be decided in accordance with law, but in accordance with some other criterion, such as what the arbitrators consider to be fair and reasonable whether or not in accordance with law, then, if that provision has any effect at all, its effect as I see it, would be that there would be no contract, because the parties did not intend the contract to have legal effect –to affect their legal relations. If there were no contract, there would be no legally binding arbitration clause, and an "award" would not be an award which the law would recognize.[210]

The cases of *Czarnikow v. Roth, Schmidt & Co.* [211] and *Maritime Insurance Company Ltd. v. Assuranz-Union von 1865* [212] were applied.

Pick v. Manufacturers' Life Insurance Company[213]

A plaintiff German Jewish national , while resident in Palestine in 1945, effected a life insurance policy with the defendant Canadian company. He paid the premiums in sterlings. The contract contained the following clauses:

> Payment of premiums: All premiums are payable in advance, either to the company at the head office or to an agent or cashier of the company in exchange for the company's official receipt signed by the general manager and countersigned by an agent or cashier of the company.
> Currency: All amounts payable under the terms of this policy, either to or by the company are payable in bankers' demand drafts in London, England for pounds sterling.

The plaintiff returned to reside in Germany in 1950. He claimed for a declaration that policy moneys were payable to plaintiff in Germany or in whatever other country he was a resident and that the contract was governed by the law of Canada, or alternatively the law of England. The defendants contended that the policy moneys were payable only in Israel in Israeli currency. The question was which law governed the contract: whether Ontario, English or Israeli law. The defendants also contended that even if Israeli law was not the proper law of the contract, if Israel was the place where the policy moneys were primarily payable, then defendants' obligation to pay policy moneys was governed by Israeli law.

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[210] Ibid., p.264.
[211] (1922) 2 K.B. 478; (1922) 12 Ll. Rep. 195. Lord Justice Bankes stated:

> That they [the arbitrators] will continue their present popularity and entertain no doubt, so long as the law retains sufficient hold over them to prevent and redress any injustice on the part of the arbitrator, and to secure that the law that is administered by an arbitrator is in substance the law of the land and not some home-made law of the particular arbitrator or the particular association.

[212] (1935), 52 Ll. Rep. 16.
[213] 1958, 2 Lloyd's Rep. 93.

Mr. Justice Diplock delivered the judgment. He made the following considerations: "In considering what is the proper law of the contract, I must take into account, not only its terms, but the surrounding circumstances in which it was made." Under English rules of private international law, the proper law of the contract depended upon the contention of the parties, and when there was no express provision on this matter, the court was performing the familiar function of construing the contract and ascertaining what term had to be implied. Since the parties suggested that either Ontario law or Israeli law differed from English law as respects rules for the construction of contracts, and in the absence of evidence that they did, the presumption was that their laws were, in that respect, the same as English law. The relevant Israeli law for the purpose of construing the contract would be that of the mandated territory of Palestine, which was the status of Israel in 1945 when the contract was made. It was not relevant that the defendants had an office in Palestine at which some insurance business was conducted, since they had no agent in Palestine authorized to enter into a contract of this kind, and there is no evidence that any employee of the company's Palestine office played any part in the formation of this contract. Technically, the contract was made in Palestine, because although signed and sealed in Toronto, it did not take effect until delivered to the plaintiff. The place of delivery was Haifa. But while considerable importance could attach to the country where the contract was made, where both parties were to perform all their respective acts necessary for its completion, less weight attached to it where the actual place of completion depended on technical matters.

The following matters indicated that the proper law was Ontario law, not the law of Palestine. The policy was a printed contract obviously in common form, issued by a Canadian company with its head office in Toronto, Ontario. The terms of the contract could only be waived or modified by endorsement signed by officials, who presumably worked at the head office. The insurance was for a sum in sterling, not in Palestine currency, and the premiums payable in sterling. The premiums were expressed to be payable at the head office or to an agent or cashier of the company, without limitation of place, and the policy moneys were payable upon delivery of the policy to the company, again without any limitation of place of delivery. The notice on the outside of the policy invited the assured to communicate directly with the company in Toronto in order to obtain

payment of any claim, or to communicate with the nearest authorized representative of the company, without limitation of place. Any assignment of the policy had to be sent at the head office in Toronto, and nowhere else. There was no relevant reference in the policy to Palestine at all.

All this, except for the provision that the policy was for a sum in sterling, seemed to point to the law of Ontario as the proper law of the contract.

Rossano v. Manufacturers' Life Insurance Co.[214]

In this case, the plaintiff who, in 1940, was an Egyptian national residing and carrying on business as a cotton merchant in Egypt, applied for three 20-year endowment policies of insurance (two in pounds and one in American dollars). The company had branches in many parts of the world with their head office in Toronto, Canada. The defendants' Cairo office issued to the plaintiff a single interim policy covering the two applications for sterling policies and later, the final policies were executed at Toronto in the plaintiff's favour, each policy being the form used by the defendants for foreign business. The total 20 years' premiums under the dollar policy were paid in advance to the head office in Toronto by means of a draft on a bank in Boston; and the plaintiff likewise paid the full 20 years' premiums in respect of the sterling policies by sterling cheque to the defendants' Cairo office. Under the first two policies, the parties agreed that money was to be made payable in banker's demand draft in London for pounds sterling. As to the third policy, it was agreed that the money was to be paid in banker's demand draft in New York for U.S dollars.

The policies all matured on March 15, 1960, and the plaintiff brought an action claiming the money due under them. The defendants relied on two defences: (a) that the proper law of the contracts was the Egyptian law because Egypt was the situs of the debt or the contractual place of performance. Payment by the defendants would be illegal under the Egyptian exchange control law if effected without the permission of the Egyptian control authorities; (b) that as there were two garnishee orders, served upon the defendants' branch in Egypt by the Egyptian revenue authorities in respect of tax alleged to be due by the plaintiff, payment to the plaintiff would expose them to penalties or to the

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[214](1963), 2 Q.B. 352.

risk of having to pay the money twice and they were, therefore not liable to pay the sums claimed.

The following factors in particular pointed to the proper law being the law of Ontario, and not Egyptian law: (a) The policies were on a standard form and there was a presumption that all policies in that form would be subject to the same law. The defendants could not have intended their policy to have different meanings in different countries. (b) At the time the contracts were entered into there was a world war in progress and the assured (who was of the Jewish faith) wanted to be able to draw money anywhere in the world. The defendants assured him that he could do so in any country in which the defendants operated subject to local regulations. (c) The defendants' Cairo office had no authority to issue policies. Such authority had to be given by the defendants' head office in Toronto. No alteration in the terms of a policy could be agreed unless agreed to in writing by the head office. Notice of any assignment had to be given to the head office. (d) Payments of amount due under the policy by or to the company were to be made in the case of the sterling policies by bankers' demand drafts on London for the pound sterling, and in the dollar policy by bankers' demand drafts on New York for United States dollars. (e) The plaintiff asked for the policy to be written in English, rather than French --the commercial language of Egypt. (f)In the case of the dollar policy the premiums were prepaid in Toronto by drafts on Boston, and it was originally agreed that this policy should be delivered in Boston, although ultimately it was in fact delivered in Cairo. (g) In the case of all the policies a claim could be made to the defendants' head office or their nearest authorized representative. (h) The defendants were incorporated and had their head office in Toronto, Ontario, and were subject to Ontario law, including the Insurance Act of Ontario, on which the form of policy was substantially based. The statutory restrictions referred to in the application form incorporated in the policy relate to the Ontario statute. (i) In the case of a 20-year endowment policy there is the possibility of a policy-holder becoming interested in the liquidation of the insurer, which in the present case would have taken place under the law of Ontario.

It was held that applying the test as laid down by Lord Symonds in *Bonython v. Commonwealth of Australia*[215] that the proper law of the contracts was the law of Ontario

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[215](1951), A.C. 201, 219; 66 T.L.R. (Pt. 2) 969, P.C.

and that the Egyptian control legislation could not apply to the policies as part of the proper law. It was also held that Egyptian control legislation did not apply to the policies merely by reason of the situs of the debt being in Egypt and that in considering what was the place of the contracts, the relevant act of performance was the payment of the and that, accordingly, the defendants could not escape liability on the policy by reason of the garnishee orders and the plaintiff's claim succeeded.

Appendix 3: Specimen of a Facultative Slip

XXX REINSURANCE COMPANY

Accident Department Guarantee No.....

Ceding Company.....

Insured.....

Policy No.....

Description of Risk and Sum insured.....

Amount Retained by Ceding Company.....

Reinsurance hereon

From..... to....... Renewal Date.....

Present Premium..... Commission.....%

Future Premium.....

The XXX Reinsurance Company hereby guarantees the ceding company to the extent shown subject to the terms and conditions of the original insurance.

Signed for and on behalf of the company this....day of...... 19.....

Appendix 4: Standard Arbitration Clause

(Institute of London Underwriters, Reinsurance Officers' Association, Lloyd's Insurance Brokers' Association).

1) All matters in difference between the reassured and the reinsured (hereinafter referred to as 'the parties') in relation to this agreement, including its formation and validity, and whether arising during or after the period of this agreement, shall be referred to an arbitration tribunal in the manner hereinafter set out.

2) Unless the parties agree upon a single arbitrator within 30 days of one receiving a written request from the other for arbitration, the claimant (the party requesting arbitration) shall appoint his arbitrator and give written notice thereof to the respondent. Within 30 days of receiving such notice the respondent shall appoint his arbitrator and give written notice thereof to the claimant, failing which the claimant may apply to the appointor hereinafter named to nominate an arbitrator on behalf of the respondent.

3) Should the arbitrators fail to agree, then they shall within 30 days of such disagreement appoint an umpire to whom the matter in difference shall be referred. Should the arbitrators fail within such period to appoint an umpire, then either of them or either of the parties may apply to the appointor for the appointment of the umpire.

4) Unless the parties otherwise agree, the arbitration tribunal shall consist of persons employed or engaged in a senior position in insurance or reinsurance underwriting.

5) The arbitration tribunal shall have power to fix all procedural rules for the holding of the arbitration including discretionary power to make orders as to any matters which it may consider proper in the circumstances of the case with regard to pleadings, discovery, inspection of documents, examination of witnesses and any other mater whatsoever relating to the conduct of the arbitration and may receive and act upon such evidence whether oral or written strictly admissible or not, as it shall in its discretion think fit.

6) The appointor shall be......

7) All costs of the arbitratton shall be in the discretion of the arbitration tribunal who may direct to and by whom and in what manner they shall be paid.

8)(a) The seat of the arbitration shall be in...... and the arbitration tribunal shall apply the laws of..... as the proper law of this agreement.

8)(b) The award of the arbitration tribunal shall be in writing and binding upon the parties who covenant to carry out the same. If either of the parties should fail to carry out any award, the other may apply for its enforcement to a court of competent jurisdiction in any territory in which the party in default is domiciled or has assets or carries on business.

Appendix 5: Types of Reinsurance

1) Proportional Reinsurance

The reinsurer receives an agreed proportion of the original premium, less commission, and pays the same proportion of all losses.

1.a) Quota Share:

A fixed proportion of all risks accepted by the primary insurer are ceded to the reinsurer.

1.b) Surplus:

Only amounts accepted by the primary insurer above its own retention are ceded to the reinsurer.

2) Non-Proportional or Excess Reinsurance

In return for an agreed premium, the reinsurer accepts liability for losses incurred by the reinsured in excess of an agreed amount, subject to a maximum limit.

2.a) Excess of Loss:

2.a.I) Excess of Loss Arranged on Risk Basis:

The reinsurer pays any loss on an individual risk in excess of a predetermined amount.

2.a.II) Excess of Loss Arranged on Occurrence Basis:

The reinsurer pays when the aggregate loss from any one occurrence exceeds a predetermined retention.

2.b) Stop Loss:

The reinsurer pays if the reinsured's aggregate net losses for a year exceed a predetermined amount and/or proportion of premium income.

Appendix 6: Methods for Placing Reinsurance

Facultative Each risk is offered individually to reinsurers, who are free to reject or accept the share they desire.

Treaty The reinsured has the obligation to cede and the reinsurer the obligation to accept the risks which fall within the terms of the contract.

Open Cover or Facultative Obligatory The ceding company or the broker have no obligation to offer any business, but the reinsurer agrees to accept obligatorily a share of any business which falls within the terms of the contract.

Pool Various insurance companies form a reinsurance company. The risks accepted by the member insurance companies are ceded to the pool, which, in turn, arranges retrocessions to the members.

Appendix 7: Specimen of a Proportional Treaty

REINSURANCE AGREEMENT between the ...... of ......(hereinafter called the 'company') of the one part, and ...... of......(hereinafter called the 'reinsurer') of the other part.

ARTICLE I

SCOPE AND COVER

1. The company binds itself to cede and the reinsurer binds itself to accept and guarantee by way of reinsurance a ......% quota share of the company's liability on each and every risk underwritten by the company in ......, either as direct business or as specific reinsurance of other companies, it being understood and agreed that this reinsurance agreement embraces:

(a) Fire and allied lines written in conjuction with fire.

(b) Inland transportation, personal property and real property (collectively referred to as inland marine).

(c) Burglary, robbery or theft.

2. It is understood and agreed that for the purposes of this agreement, the company's liability shall not exceed $...... any one risk. The company shall be the sole judge of what is considered as one risk.

3. The company and the reinsurer each reserve the right to take out and maintan excess or catastophe covers for the classes of business embraced by this agreement, and the other party shall in no case participate in the premium, nor in any payments from, such covers.

ARTICLE II

EXCLUSIONS

1. Notwithstanding anything to the contrary contained herein, this agreement does not cover loss or damage directly or indirectly occasioned by, happening through or in consequence of war, invasion, act of foreign enemy, hostilities (whether war be declared or not), civil war, rebellion, revolution, insurrection or military power.

2. This agreement is subject to the nuclear incident exclusion clause–physical damage–reinsurance (Canada).

ARTICLE III

COMMENCEMENT AND DURATION OF CESSIONS

1. The obligation of the reinsurer on business written commences and expires simultaneously with that of the company and is subject to all the general and specific stipulations, clauses, waivers and modifications of the original policies and/or binders and any endorsement thereon.

ARTICLE IV

RATES OF PREMIUM

1. All cessions under this agreement shall be subject to the same rates and conditions as the original insurance insurances or reinsurances.

ARTICLE V

RECORD OF CESSIONS

1. The company shall keep at its office records of all risks ceded to the reinsurer. All entries in these records shall be binding on the reinsurer. All records of the company relating to any reinsurance or any loss hereunder shall be open to inspection by a duly authorized representative of the reinsurer at any reasonable time.

ARTICLE VI

ERRORS AND OMISSIONS

1. Inadvertent errors and omissions in applying the present agreement shall not prejudice the rights of either party but shall be rectified as soon as possible.

ARTICLE VII

LOSSES AND LOSS SETTLEMENTS

1. All losses and compromises of losses and expenses and allowances in consequence of loss, shall be settled by the company without the intervention of the

reinsurer, and the reinsurer shall accept the settlement of the company as the sole warrant for the payment of its proportion of the loss and attendant expenses.

2. The company may likewise, at its sole discretion, commence, continue, defend, compromise, settle, or withdraw from actions, suits or prosecutions and generally, do such matters and things relating to any claim or loss as in its judgment may be beneficial or expedient, and the payment and expense in connection therewith shall the shared by the reinsurer proportionally to its share of the original cession. The reinsurer shall likewise participate in any salvage or other reimbursements received.

3. The amount of loss settlements due from the reinsurer in respect of business under this agreement shall be included in the quarterly accounts provided, however, that when the amount due from the reinsurer as the result of any one loss, exceeds its proportion of $..... it will, at the option and upon demand by the company, be paid by special remittance immediately upon receipt of the loss details.

ARTICLE VIII

ACCOUNTS

1. The company shall furnish the reinsurer with quarterly accounts as soon as possible after the close of each quarter, but in any event, not later than 30 days after the close of the quarter.

2. The reinsurer shall send relevant objections to the ceding company within three weeks following receipt of the account.

3. The company shall remit balances shown in the accounts to the reinsurer at the same time as the accounts are rendered. The reinsurer shall remit balances due to the company upon receipt of the accounts, but at the latest, within ten days following receipt of the accounts.

4. Following the immediate clarification of any questions which have arisen, the difference in amount, if any, shall be settled at once by the debtor party unless it is mutually agreed that such difference shall be settled in the following account.

ARTICLE IX

COMMISSION AND TAX

1. To cover all acquisitions and other costs, including taxes, the reinsurer shall allow the company a commision of ......% upon the net premiums ceded, which shall mean original gross premiums ceded less returns and cancellations, such commission to be calculated in the quarterly accounts provided for in article VIII.

ARTICLE X

ARBITRATION CLAUSE

1. All irreconciliable disputes or differences arising between the contracting parties hereto, with reference to any transactions under this agreement, shall be settled by arbitration.

2. Each party shall nominate an arbitrator and the two named shall select an umpire before entering upon the arbitration. The arbitrators and umpire shall be disinterested executive officers of insurance or reinsurance companies transacting business in ...., other than the parties signatories to this agreement.

3. In the event of one of the parties failing to name its arbitrator within thirty days of the date upon which a demand for arbitration is made, or the two arbitrators failing to name an umpire within thirty days of their acceptance of appointment, the required arbitrator or umpire, as the case may be, shall be selected by ...... If an arbitrator or umpire, after being appointed, is unable or unwilling to act, a new arbitrator or a new umpire, as the case may be, shall be appointed to act in his place, in accordance with the procedure indicated in this article.

4. Each party shall submit its case in writing to the arbitrators within thirty days from the date of appointment of the umpire, but this period of time may be extended by majority consent, in writing, of the arbitrators and umpire.

5. The two arbitrators shall consider from the written cases submitted to them what disputes or differences exist between the parties. Should they fail to agree, they shall inform the umpire of the points on which they have agreed and shall consider with him the points still unresolved and shall generally make available to the umpire all information in their possession relating to the arbitration.

6. The arbitrators and umpire shall make their award and shall direct the bearing of costs with a view to effecting the general purpose of this agreement in a reasonable

manner, and may abstain from following the strict rule of the law, interpreting the present agreement as an honourable engagement and not as a merely legal obligation.

7. The decision of the arbitrators, or, in the event of their not agreeing, the majority decision of the arbitrators and umpire, shall be final and binding upon both parties and shall be filed in writing with both parties. Arbitration shall take place in...... unless otherwise mutually agreed.

ARTICLE XI

SPECIAL TERMINATION

1. It is especially understood and agreed that, should at any time during the currency of this agreement, either party:

a) lose the whole or any part of its paid up capital;

b) go into liquidation or have a receiver appointed;

c) amalgamate with any other company or come under the control of any other company, corporation, individual or individuals by reason of its shares been purchased by the aforementioned;

d) agree to any arrangement which would end its separate existence;

e) be 100% reinsured without previous written consent of the other party, or

f) cease writing either new or renewal business by decree of an Insurance Department or other competent authority,

it shall give immediate advice of the fact to the other party, which shall have the right to terminate this agreement fortwith upon the giving of notice in writing to the affected party.

2. Upon termination of this agreement, as provided in paragraph 1 above, at the request of the unaffected party, the unearned premium reserve shall be returned by the reinsurer in accordance with the provisions of paragraph 3 of article XII of this agreement.

ARTICLE XII

COMMENCEMENT AND TERMINATION

1. This agreement shall commence at 00:00 hours of the .... of .... It is concluded for an indefinite period but either party shall be at liberty to terminate the agreement by

giving the other at least 3 months notice, such notice to expire at 24:00 hours on the 31st of..... following receipt of the notice.

2. All notices of termination shall be in writing by registered letter, telex or telegram, and addressed to the party at its head office or at any other address which it may have designated for such purpose.

3. Upon termination of this agreement, as provided in paragraph 1 above, at the request of either party, the unearned premium reserves, calculated at 100% on the Department of Insurance basis, shall be returned by the reinsurer. From the reserve shall be deducted commission at the rate specified in paragraph 1 of article IX of this agreement. Failing this request, cessions under this agreement shall run to their natural expiry.

4. Notice of intention to withdraw or return the portfolio shall be given by the party rendering notice at the time such notice is rendered, or by the party receiving notice when acknowledging it.

5. It is understood and agreed that all times mentioned in this article shall refer to local time where each risk reinsured is located.

ARTICLE XIII

ALTERATIONS

1. Any alterations to this agreement which may from time to time become necessary, shall be made by correspondence or by an addendum, the correspondence or addendum to be taken as part hereof and become equally binding.

Made in duplicate and signed at...... on behalf of the ...., this day..... of 197..... and at...... on behalf of the....... this day....... of 197.....

Appendix 8: Specimen of a Non-Proportional Treaty

EXCESS OF LOSS REINSURANCE AGREEMENT between the ..... of..... (hereinafter called the 'company') of the one part, and the...... of......(hereinafter called the 'reinsurer') of the other part.

ARTICLE I

CLASSES OF BUSINESS

1. This agreement, subject to the provisions of article 2, shall apply to policies in respect of insurance or facultative reinsurances as original, underwritten by the company in ..... covering:

(a) Automobile (all hazards);

(b) General third party bodily injury (including death) and property damage liability, including employer's liability, voluntary compensation, workmen's compensation and/or Common Law liability and tenants' fire legal liability.

2. A policy issued by the company wherein the company is named as the insured either alone or jointly with another party shall, subject to the other terms of this agreement, be deemed to be a policy coming within the scope of this agreement, notwithstanding that no legal liability may arise in respect thereof by reason of the fact that the company is the isured or one of the insureds.

3. This agreement applies to business assumed by the company as a subscriber to the facility, and in respect of business ceded to the facility, it applies to the portion retained but excludes the portion ceded by the company.

ARTICLE 2

EXCLUSIONS

1. The reinsurer shall not be liable for claims in respect of:

(a) Risks of a type normally referred to the Nuclear Insurance Association of ......

(b) Claims excluded under either nuclear exclusion clause and loss or damage due to contamination by radioactive material.

(c) Insurance written on an excess of loss basis other than that written using normal deductibles.

(d) Loss or damage caused by war, invasion, act of foreign enemy hostilities (whether war be declared or not), civil war, rebellion, revolution, insurrection or military power.

(e) Risks excluded under the exclusion list attached.

(f)All inwards reinsurance.

ARTICLE 3

EXCESS AND LIMIT OF LIABILITY

1. The reinsurer agrees for the consideration thereafter appearing, to pay the company the ultimate net loss which the company shall become liable to pay in excess of $...... ultimate net loss on account of each and every accident or occurrence involving policies reinsured hereunder.

2. The liability of the reinsurer in respect of each and every accident or occurrence as aforesaid, shall be limited to $......

ARTICLE 4

DEFINITION: ULTIMATE NET LOSS

1. The term "ultimate net loss" is understood to mean the sum actually paid by the company in settlement of losses or liability after making deductions for all recoveries, all salvages and all amounts recoverable under other reinsurances, whether collected or not and shall include all adjustment and litigation expenses arising from the settlement of losses or liability other than the salaries of employees and office expenses of the company.

2. Nothing, however, in this article, shall be construed as meaning that losses are not recoverable hereunder until the ultimate net loss of the company has been ascertained.

3. Recoveries and salvages recovered or received subsequent to a loss settlement and all necessary adjustments shall be made by the parties hereto.

4. The liability of the reinsurer hereunder, in respect of each net loss, shall not be increased by reason of the inability of the company to recover from any other reinsurers

any amounts which may have become due from them, whether such inability arises from the insolvency of such other reinsurers or otherwise.

ARTICLE 5

DEFINITION OF EVENT

1. It is understood and agreed that whenever used in this agreement, the terms "event" and "occurrence" shall be held to have the following meaning:

(a) as applied to the perils of windstorm, hail, tornado, cyclone and hurricane, all losses occasioned by these perils which arise out of one atmospheric disturbance during a continuous period of 72 hours;

(b) as applied to earthquake and/or fire following upon and resulting directly from earthquake, all losses occasioned by this peril which occur during a continuous period of 72 hours.

(c) as applied to the perils of riot, civil commotion, vandalism and malicious mischief, all losses occasioned by these perils which occur during a continuous period of 72 hours and within the limits of any one city, town or village (the definition of city of twon being the metropolitan area thereof) or, if the company so elects, within the limits of a contiguous area of one square mile;

(d) as applied to all other perils covered by this agreement, one or more losses arising out of or resulting from the same cause, it being understood and agreed that no event or occurrence shall exceed a continuous period of 168 hours.

ARTICLE 6

RATE AND PREMIUM

1. The premium payable by the company to the reinsurer for each annual period this agreement is in force shall be calculated at the rate of 4.00% on the gross net earned premium of the company, i. e., gross premiums less cancellation and return premiums and less premiums paid for reinsurance enuring to the benefit of this agreement.

2. In respect of each calendar year, the company shall pay to the reinsurer a deposit premium of $...... payable in four equal quarterly instalments in advance.

ARTICLE 7

CHANGE IN CONDITIONS

1. If, after the conclusions of negotiations as to terms of this agreement, the conditions under which the business reinsured is transacted are changed by the company without the agreement of the reinsurer, or altered by law, market practice or the like, in such a way as materiality to increase the potential liability of the reinsurer, then the parties agree to negotiate immediately such revision in the terms hereof as are necessary.

ARTICLE 8

CLAIMS

1. The company shall at its sole discretion commence, continue, refund, compromise, settle or withdraw from actions, suits and proceedings and generally do all such matters and things relating to claims as in its judgment may be beneficial and expedient.

2. All claims settlements including ex gratia payments made by the company shall, subject to the terms of this agreement, be binding upon the reinsurer. Expenses, including the cost of investigation, adjusting, settling and examining claims incurred in respect of employees of the company or its agents, but including legal cost and fees, shall be included in the amount of the claim when calculating the liability of the reinsurer in respect of either settled or oustanding claims.

3. The reinsurer shall be entitled to the benefit of any salvage and/or recoveries advised before or subsequent to the settlement of any claims up to the limit of the amount paid by the reinsurer.

4. The company shall give immediate advice to the reinsurer on the forms provided, of each accident or event where the amount of the loss or losses combined are estimated to amount to 75% or more of the retention current under this agreement at the date of the loss. In addition, all claims involving the following shall be advised to the reinsurer at the same time as the company learns of their existence: all fatals, brain injuries, paralysis of limbs, amputations of or permanent loss of use of limbs, serious injuries to both eyes, all cases where a permanent disability of 50% or more is likely to result and all bodily injury claims resulting in an annuity or annuity type series of payments over a period

of more than six months.

5. The company shall keep the reinsurer advised as to the developments in respect of claims likely to affect the cost of any claim under this agreement or when the settlement of large claims may be imminent and the two shall co-operate in respect to the handling of claims as seems best in their joint interest.

6. All claims items payable by the reinsurer shall be reimbursed to the company immediately on written demand received by the reinsurer.

7. As soon as possible after 31st December each year, the company shall forward to the reinsurer a list of claims outstanding at 31st December, together with a separate list of claims reserved for more than 75% of the retention but not exceeding it. When establishing reserves, the company shall take into account, as far as possible, the trend in claims values, any increase likely due to time passing between the date of the assessmet and the ultimate settlement, interest, cost, fees and expenses, together with a pessimistic assessment as to whether or not the insured may be held liable for the injuries or damage.

ARTICLE 9

INDEXATION CLAUSE

1. It is the intention of this agreement that the stated retention of the company shall be adjusted to retain its relative value which exists at the commencement of the agreement. Such relative value shall be deemed to be based on the Index of Average Hourly Earnings in Manufacturing Industries issued by Statistics Canada and published in Cataloque No. 72-002 by Information Canada, Ottawa.

2. In respect of claims under this agreement arising from accidents occurring on or after the 1st day of January ....., the company shall submit a list of payments making up each such claim. The reinsurer shall adjust the amount of each payment to its relative value as at January 1, ... by the following formula:

Amount of payment x Index for January 1, ...

Index for Month of Payment

equals the Adjusted Payment Value

To avoid delay in payment of the reinsurer's liability hereunder, the final payment (s) by the

ceding company in respect of a claim shall be adjusted in accordance with the last available monthly Index, instead of the Index for the month of payment.

The adjusted retention of the company in respect of such claim shall then be calculated as follows:

Total Actual Payments

Total Adjusted Payment Values

multiplied by the Stated Retention

equals the Adjusted Retention

Nothing herein contained shall preclude interim payments by the reinsurer in partial discharge of its liability under this agreement. When such interim payments are made, the calculation of adjusted retention shall be deemed provisional and subject to final adjustment when the final payment is made by the company.

3. If the Index specified in section 1 above shall be revalued by Statistics Canada, the necessary recalculations shall be made to re-establish the Index to its form before such revaluation. If such recalculation is not possible, the parties shall select such other comparable Index as they may mutually agree upon.

In consideration of the retention adjustments to be made in accordance with section 2 above, it is understood and agreed that the maximum liability of the reinsurer, under this agreement, in respect of any one accident or occurrence, shall not exceed the limits stated in article 3, section 2, nor shall the operation of section 2 above reduce the adjusted retention below the retention stated in article 3, section 1.

ARTICLE 10

INSPECTION – ERRORS AND OMMISSIONS

1. The reinsurer may, by a duly appointed representative, inspect at any reasonable time at the office of the company, any books and/or documents referring to any reinsurances under this agreement, provided always that the reinsurer shall have given to the company fourteen days notice of its intention to do so.

2. Accidental errors or ommissions relating to premium or claim hereunder, shall not invalidate this agreement, but same shall be duly corrected as soon as possible after detection.

ARTICLE 11

ARBITRATION CLAUSE

1. All irreconciliable disputes or differences arising between the contracting parties hereto, with reference to any transactions under this agreement, shall be settled by arbitration.

2. Each party shall nominate an arbitrator and the two named shall select an umpire before entering upon the arbitration. The arbitrators and umpire shall be disinterested executive officers of insurance or reinsurance companies in ...... other than the parties signatories to this agreement.

3. In the event of one of the parties failing to name its arbitrator within thirty days of the date upon which a demand for arbitration is made, or the two arbitrators failing to name an umpire within thirty days of their acceptance of appointment, the required arbitrator or umpire, as the case may be, shall be selected by the ...... If an arbitrator or umpire, after being appointed, is unable or unwilling to act, a new arbitrator or a new umpire, as the case may be, shall be appointed to act in his place, in accordance with the procedure indicated in this article.

4. Each party shall submit its case in writing to the arbitrators within thirty days from the date of appointment of the umpire, but this period of time may be extended by majority consent, in writing, of the arbitrators and umpire.

5. The two arbitrators shall consider from the written cases submitted to them, what disputes or differences exist between the parties. Should they fail to agree, they shall inform the umpire of the points on which they have agreed and shall consider with him the points still unresolved and shall generally make available to the umpire all information in their possession relating to the arbitration.

6. The arbitrators and umpire shall make their award and shall direct the bearing of costs with a view to effecting the general purpose of this agreement in a reasonable manner and may abstain from following the strict rule of law, interpreting the present agreement as an honourable engagement and not as a merely legal obligation.

7. The decision of the arbitrators, or, in the event of their not agreeing, the majority decision of the arbtrators amd umpire, shall be final and binding upon both parties and shall be filed in writing with both parties. Arbitration shall take place in......, unless

otherwise mutually agreed.

ARTICLE 12

SPECIAL TERMINATION

1. It is especially understood and agreed that should at any time during the currency of this agreement either party:

a) lose the whole or any part of its paid–up capital;

b) go into liquidation or have receiver appointed;

c) amalgamate with any other company or come under control of any other company, corporation, individual or individuals by reason of its shares having been purchased by the aforementioned;

d) agree to any arrangement which would end its separate existence;

e) be 100% reinsured without previous written consent of the other party, or

f) cease writing either new or renewal business by decree of an Insurance Department or other competent authority,

it shall give immediate advice of the fact to the other party which shall have the right to terminate this agreement forwith upon the giving of notice in writing to the affected party.

2. Upon termination of this agreement, as provided in paragraph 1 above, all liability of the reinsurer shall cease absolutely except as provided for in paragraphs 3 and 4 of article 13 of this agreement.

ARTICLE 13

COMMENCEMENT AND TERMINATION

1. This agreement shall commence at 12:01 hours on 1st of January .... and applies to all claims arising on or after that date, regardless of the date of issue of the policy or policies concerned. It is concluded for an indefinite period but either party shall be at liberty to terminate the agreement by giving the other at least 3 months' notice, such notice to expire at 12:00 hours on 30th of June or 31st of December following receipt of the notice.

2. All notices of termination shall be in writing by registered letter, telex or telegram, and addressed to the party at its head office or at any other address which it

may have designated for such purpose.

3. Upon termination of this agreement, the liability of the reinsurer shall cease absolutely, except in regard to claims arising during the currency of this agreement and not settled at the date of such termination.

4. If this agreement shall terminate while a loss is in progess, it is understood and agreed that, subject to the other conditions hereof, the reinsurer is liable for its proportion of the entire loss or damage.

5. It is understood and agreed that all times mentioned in this article shall refer to local time where each risk reinsured is located.

ARTICLE 14

ALTERATIONS

1. Any alterations which may from time to time become necessary to this agreement, shall be made by correspondence or by an addendum, to be taken as part hereof and equally binding.

Made in duplicate and signed at...... on behalf of the...... this.... day of.... 197.....
and at...... on behalf of the .... this..... day of ..... 19....